

Beyond COVID-19: Prospects for Economic Recovery in Central Asia



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Foreword

The impact of the COVID-19 pandemic on the economies of Central Asia has been profound, and will have serious implications for their continued development and diversification in the years to come. Throughout 2020, the OECD Eurasia Competitiveness Programme produced a series of regional notes that assessed the economic impact of the crisis as it unfolded. This report builds on those earlier efforts and gives a thorough assessment not only of the short-term consequences of the pandemic for the region's economies, but also of the medium and longer-term implications for Central Asia's economic trajectory. To this end, the report draws upon a wide range of OECD work. In the sections on the business climate and implications for investment attraction in the recovery period, the report draws in particular on *Improving the Legal Environment for Business and Investment in Central Asia*, released in April 2021. In other sections, the analysis draws upon OECD reports produced during the pandemic, notably *Gender Gaps in Eurasia* and *Informality in Eurasia*, both of which appeared in early 2021. The report also draws upon the latest OECD work on such critical issues as digitalisation, the green transition and public finance management.

Reflecting upon a number of long-standing structural issues in the region, as well as a range of phenomena and processes in the global economy, the report offers some initial guidance for a roadmap to *build back better*. At the heart of it is the need to ensure that the region's private sector can make a bigger contribution to growth and job creation, and that its economic growth can be more sustainable and inclusive as a result. This analysis is not exhaustive, nor is it meant to be. There are some important omissions that ought be mentioned. First, the scope is limited to Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Secondly, a number of important issues are addressed only indirectly. Notable omissions include questions around competition and skills, two topics that the OECD Eurasia Competitiveness Programme hopes to address in separate work in the coming years. Thirdly, given the relative brevity of the report, and the implications this has for the granularity available for each policy area, the report does not give concrete policy recommendations for specific countries, but rather suggests a number of broader priorities for consideration. The development of more detailed recommendations will begin at the EU-Central Asia Economic Forum in Bishkek in November 2021.

The purpose of this report is to help the governments of Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan identify policies that will help their private sectors play a significant role in the economic recovery from the crisis, and to contribute to more inclusive and sustainable future growth. Chapter 1 analyses macro-economic impacts of COVID-19 on the economies of the region and assesses the overall economic responses by government, including the underlying factors affecting their policy options. Chapter 2 focuses on four policy areas that will be central to recovery: revenue management, improving the business climate, digitalisation, and the green transition. Chapter 3 explores one specific means to ensure that policies reflect the *de facto* reality for and needs of businesses. It analyses the contribution of business intermediary organisations (BIOs) to private sector recovery through direct service provision and dialogue with governments. The last section concludes with some considerations for the way forward.

Acknowledgements

This report complements and extends work undertaken by the Eurasia Competitiveness Programme in 2020 and 2021 on the impact of the COVID-19 pandemic on the economies of Central Asia. The work was realised within the framework of the EU-funded Central Asia Invest Programme.

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The main author of the report was Mr Luke Mackle, with significant contributions from Ms Amélie Schurich-Rey, Policy Analyst/Economist, Ms Talisa zur Hausen, Policy Analyst, and Ms Katrina Keegan, Junior Policy Analyst, all of the OECD Eurasia Division. The authors are grateful for the analytical and research assistance provided by Mr Alexis Patin and Mr César Bernard, Junior Policy Analysts at the OECD Eurasia Division. Mrs Anna Chahtahtinsky and Ms Mariana Tanova, Programme Assistants in the OECD Eurasia Division, provided valuable assistance throughout the project, while Ms Elisa Larrakoetxea, Project Administrator in the OECD Eurasia Division, provided valuable editorial assistance in preparing the final report.

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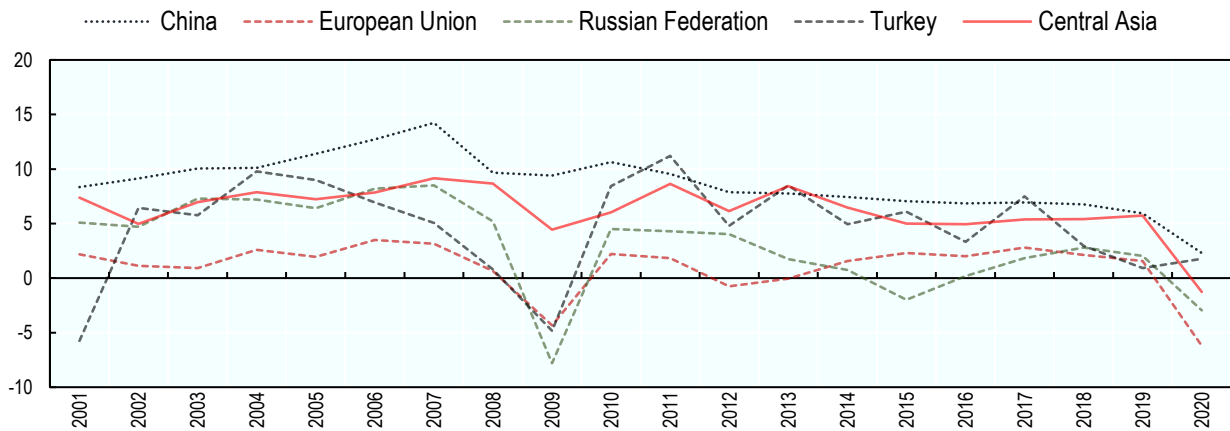
Introduction

COVID-19 in Central Asia: fragilities old and new

The arrival of the COVID-19 pandemic in Central Asia in early 2020 caused enormous social and economic upheaval in a region still reeling from the effects of the 2008-09 Global Financial Crisis and the 2014-15 commodity price shock. Economic performance in the wake of these earlier crises suggested that the commodity-driven and cyclical growth paths pursued by most countries across the region had begun to run out of steam even before the pandemic: trend GDP growth was decelerating, productivity growth stagnating, inequality rising, and convergence with OECD and EU countries slowing (OECD, 2020^[1]). The declining potential of extractives-and particularly hydrocarbon- driven growth also affected countries that were less important exporters of fuel and metals, such as Kyrgyzstan and Tajikistan. They had long exported surplus labour and received large remittance inflows in return. Their economic health and stability thus depended greatly on labour-market conditions in richer neighbours, particularly Russia and to some extent Kazakhstan. Central Asian states were thus struggling to recover growth momentum and lay the foundations for new growth models when the COVID-19 pandemic hit the region – initially through the trade channel and then with the arrival of the virus itself.

Thus, fundamental structural weaknesses rendered the countries of Central Asia particularly vulnerable to the shockwaves that the pandemic would unleash. The impact on local economic activity was profound, with businesses shuttered as containment measures were introduced in most countries, mobility was curtailed, and borders were temporarily closed. Yet, the impact of the crisis on the region's economies has been particularly severe since disruptions to trade, weak global demand for energy and commodities, and limits on the movement of people all affected the region's major growth drivers. Complicating matters is the fact that the recovery of these growth drivers depended largely on factors beyond the control of governments in the region. While Central Asia may be geographically remote, its economic growth is nevertheless closely intertwined with demand from a number of external centres of global demand (Figure 1).

Figure 1. Real GDP growth in Central Asia and key regions



Source: (World Bank, 2021^[2])

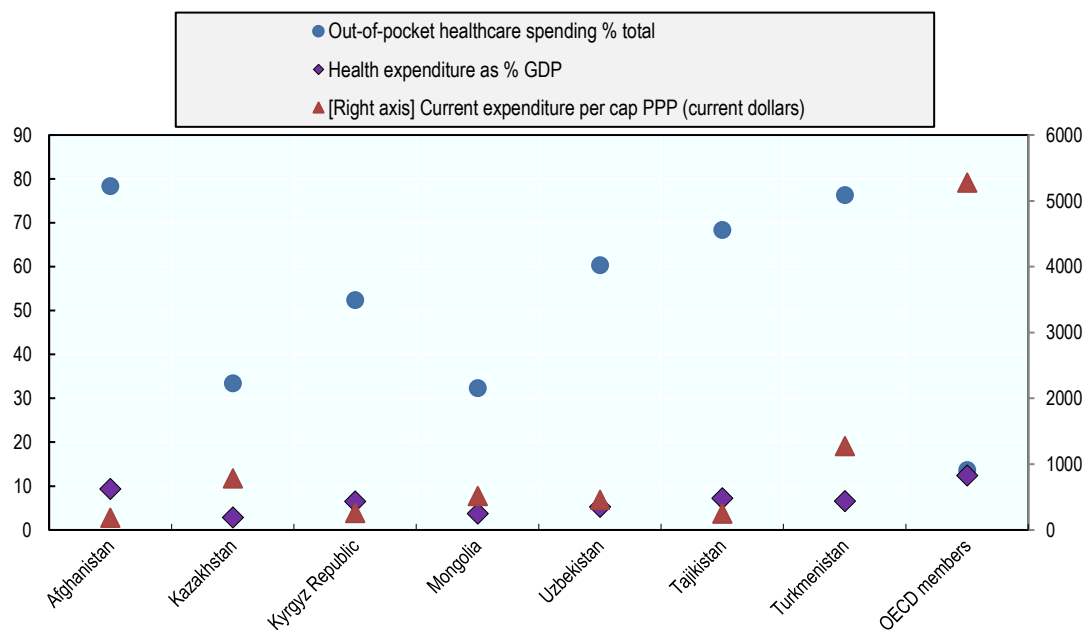
Central Asia's aggregate GDP shrank by 1.7% in 2020 on the official data (Figure 1), erasing at least four years of per capita income gains for some economies in the region and reversing progress made in reducing poverty (World Bank, 2021^[3]). Across Central Asia, an estimated 1.4 million people were pushed into poverty, which represents 58% of the total poverty increase across the entire Europe and Central Asia region as defined by the World Bank (Ibid.). The impact on countries where the extractive and tourism sectors play a key role, such as Kazakhstan and Kyrgyzstan, has been especially significant; their economies contracted by 2.5 and 8% respectively. Indications from Google Mobility data suggest that economic activity in Q1 2021 remains significantly below the baseline despite the removal of containment measures (Chapter 1). In every country of the region, there are indications that the recovery might be slower than initially expected. The lingering effects of the pandemic and a slow vaccination rollout may moderate growth in the medium term, and lead to slower convergence with advanced OECD economies in the longer term.

Assessing the public health impact of the pandemic

When the pandemic first hit Central Asia in spring 2020, most governments were quick to implement containment measures. This helped limit the spread of the virus and alleviate the pressure on weak and underfunded healthcare systems. Healthcare systems in Central Asia have long suffered from underfunding, corruption, and limited spare capacity, and they are beset by significant regional disparities in quality and access. Healthcare spending in the region is significantly lower than in OECD countries, both as a share of GDP and in per capita terms (Figure 2).

Figure 2. Key healthcare indicators, Central Asia and OECD

Government healthcare expenditure is significantly lower than in the OECD in both per capita terms (at PPP) and as a percentage of GDP, whereas the share of healthcare spending borne by households is much higher in Central Asia.



Note: Most recent data is 2018.

Source: (World Bank, 2020₍₄₎)

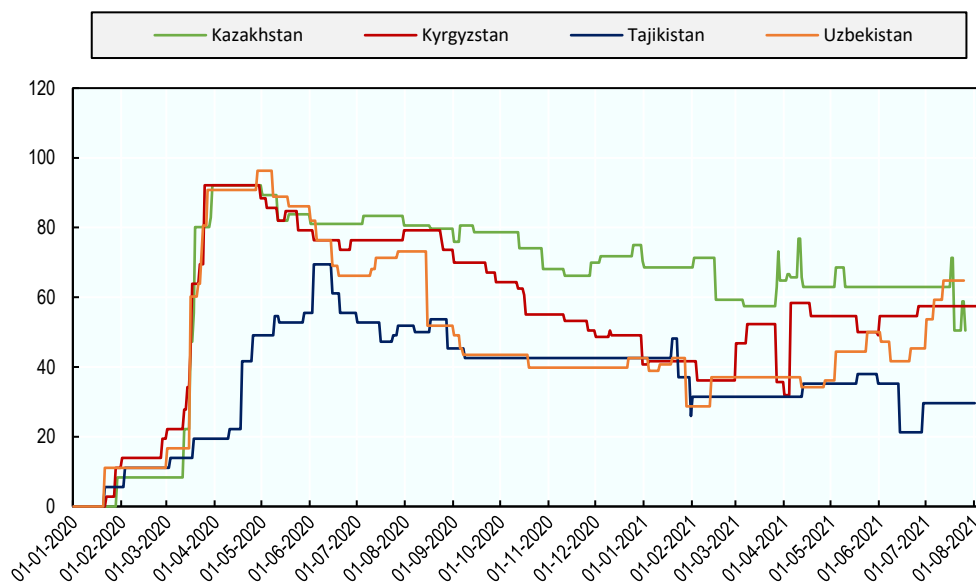
In this context, any significant outbreak of the virus risks quickly overwhelming the region's health and social infrastructure. Central Asia has some of the highest out-of-pocket shares of healthcare expenditure in the world, and therefore any deterioration in the public health situation would create significant additional pressures on household finances and the public administration. Marked increases in poverty across the region would exacerbate this dynamic.

The public health impact of the pandemic has been substantial

In responding to the public health emergency, Central Asian governments adopted measures that broadly mirrored those seen in other areas of the world. As the pandemic began, they closed their borders to prevent the arrival of new cases from abroad. Policy-makers then designed and implemented national and localised lockdowns, introduced restrictions on internal mobility and the use of public spaces, and closed schools, workplaces, and businesses, in addition to various compulsory sanitary measures. International travel all but stopped in its entirety, and the movement of citizens within and between cities and regions plummeted (OECD, 2020₍₁₎). Certain aspects of the region's geography and location may have eased the administration of some of these measures, but the closures and mobility constraints also highlight the importance of inter-regional connectivity for Central Asia's economies and societies.

The severity of measures taken by governments was broadly in line with that seen in OECD countries. Data from the University of Oxford's 'Stringency Index' shows a rapid introduction of containment measures in spring 2020. In Q3-Q4 2020, many of these measures began to wind down, though a number of restrictions – notably on international mobility – remained in place through Q1-Q2 2021 (Figure 3).

Figure 3. Stringency of containment measures in Central Asia



Note: The 'stringency' of measures is evaluated by researchers at the Blavatnik School of Government at the University of Oxford. The index is calculated on a scale of 0-100, where 0 is equal to no restrictions and 100 is equal to a high level of restrictions. An assessment is made of nineteen policy areas relating to government responses to the pandemic, including lockdowns and support measures, with the final score being a composite of these individual assessments. The index does not indicate the effectiveness of measures. Data not available for Afghanistan and Mongolia.

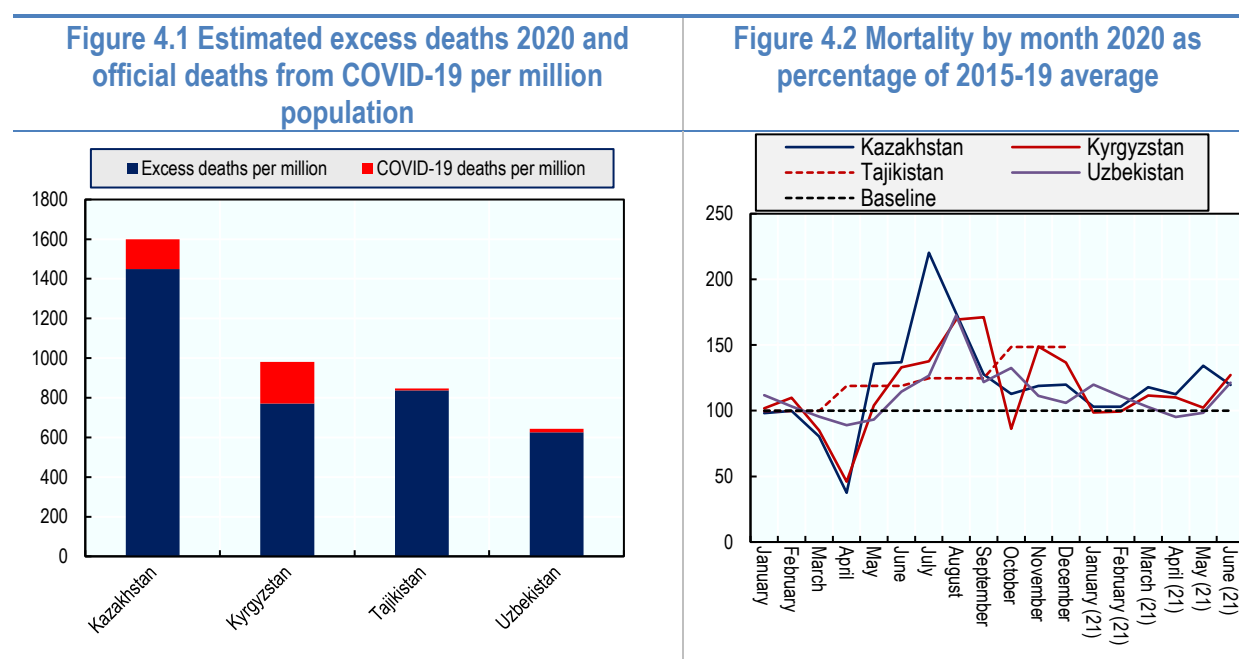
Source: (University of Oxford, 2021^[5])

The official data suggest that these measures were effective in containing the spread of the virus in Central Asia and that they avoided the morbidity and mortality rates seen in many OECD countries. As of June 2021, Kazakhstan had officially registered 7,589 cases, Kyrgyzstan 1,916, Tajikistan 91, and Uzbekistan 713. Turkmenistan had yet to report a single case of the virus on its territory.

However, mortality data suggest that the public health impact of the pandemic has been substantial. Estimated levels of excess mortality suggest a profound health crisis in Central Asia. Figure 4 shows monthly deaths in 2020-21 as a percentage of the average for the corresponding months in 2015-19, an approach widely used by OECD members' statistical agencies to assess the broader public health impact of the crisis.¹ The estimates shown are fairly rough, inasmuch as they make no demographic or other adjustments, which might affect the figures at the margins, but rather provide a good indication of the magnitude of the health impacts. Indeed, they are likely to be very conservative overall, as they take no account of the sometimes substantial reductions in deaths from other causes occasioned by masking, lockdowns and other confinement measures.

¹ Data on excess mortality has been taken from Our World in Data *Excess Mortality* database, which can be found [here](#). Official case and mortality figures refer to data collected by the European Centre for Disease Prevention and Control, which is updated daily and available [here](#).

Figure 4. Excess mortality in Central Asia



Notes for Figure 4.2: (1) Figures are calculated against the annual and monthly mortality in 2020 as a percentage of 2015-19 average; (2) data for Tajikistan are quarterly over the same period owing to the country's reporting practices; (3) data for Turkmenistan are not available. Source: OECD calculations for 2020 Statistical agencies of Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan; for 2021, data taken from (Karlinsky and Kobak, 2021^[6])

Excess mortality data suggest that the virus circulated widely in Central Asia, with a significant surge occurring in summer 2020, in stark contrast to the official data (Figure 4.2). While not all excess deaths are directly attributable to COVID-19, the figures give a rough indication of the public health impact of the pandemic and illustrate the difficulty in ensuring accurate reporting of COVID-19 cases and deaths across much of the region. In Kazakhstan and Kyrgyzstan, excess mortality not only remained above the 2015-19 baseline in mid-2021, but it was again trending upwards at mid-year (Figure 4.2).

That so few of the excess deaths were officially attributed to COVID-19 in 2020 suggests that causes of death were either incorrectly recorded or there was insufficient testing capacity, particularly outside of capital cities, where healthcare capacity is generally lower. It is also the case, in Central Asia as elsewhere, that reporting cause of death is invariably somewhat subjective, since most deaths from illness involve multiple causes. Many COVID-related deaths occur from other ailments that COVID has helped trigger or aggravate.

The challenge of correctly attributing the cause of death throughout the pandemic is one that has been faced by governments across the world. Even those methodologies used to identify fatalities caused directly by COVID-19 – as opposed to indirect attribution as a result of the virus precipitating other illnesses, or fatalities due to missed medical appointments and stretched healthcare infrastructure – produce highly variable results. A recent update in the methodology used by the Institute for Health Metrics and Evaluation at the University of Washington is indicative of the challenges encountered in correctly attributing the share of excess mortality to COVID-19: the institution's update suggests that in Kazakhstan, for example, over eighty-four thousand people died from COVID-19 – significantly more than the 5,810 deaths officially reported (IHME, 2021^[7]). There is no one agreed approach to correctly recording the impact of COVID-19

on national mortality rates, and across OECD member states, statistical agencies and public health authorities continue to discuss the challenges faced in developing and applying accurate methodologies (OECD, 2020^[8]).

Nevertheless, the magnitude of the gaps between officially reported COVID-19 deaths and excess mortality seen in Figure 41 presents a policy problem. At a time when public trust is crucial to the success of vaccination campaigns, governments need to be as open about the costs and risks associated with the virus as possible. There has been improvement on this front in Kazakhstan and Kyrgyzstan. Preliminary data from January-April 2021 from these countries suggest that nearly all excess death compared to the 2015-2019 average baseline can be attributed to official COVID-19 death tolls, implying a substantial improvement in reporting (WHO, 2021^[9]; National Statistical Committee of the Kyrgyz Republic, 2021^[10]; Bureau of National Statistics, 2021^[11]).

Effective vaccination campaigns will be essential for social and economic recovery

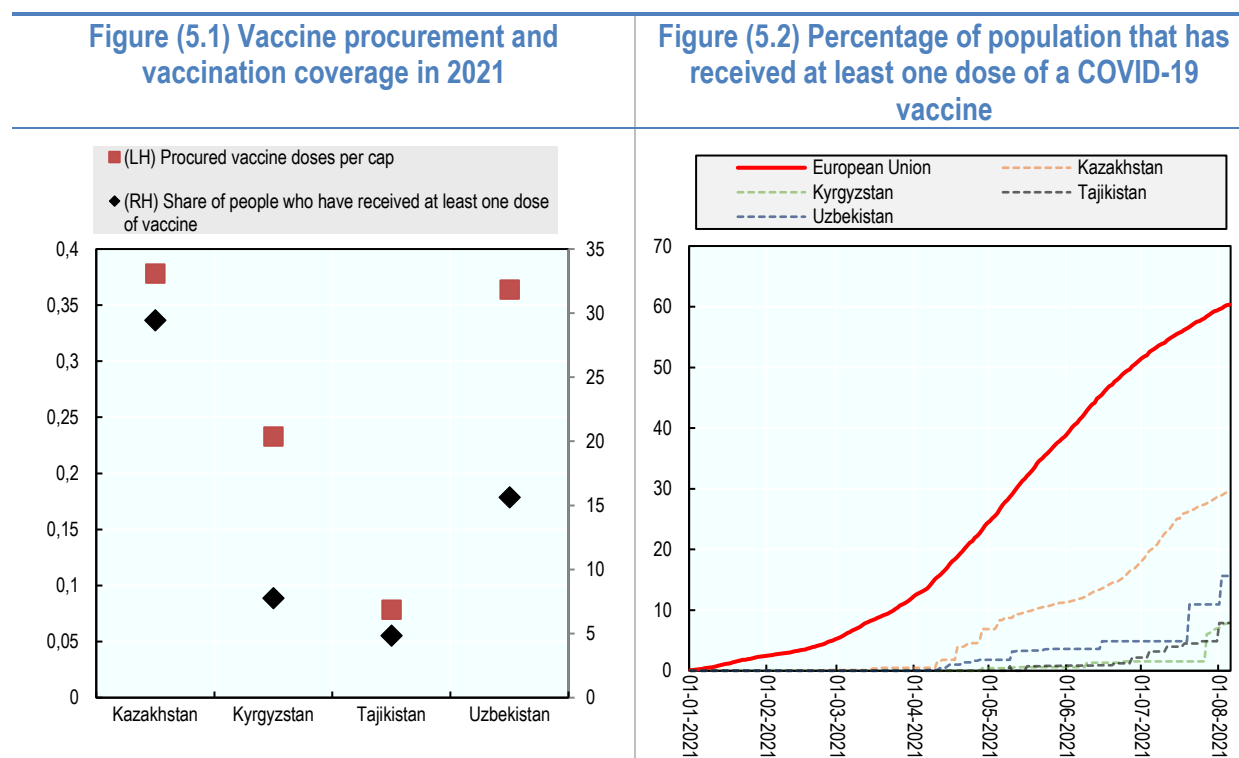
Central Asia's short-to-medium term economic recovery prospects, like those of other regions, largely depend on the effectiveness of vaccination programmes. Slow vaccine rollouts – especially if poor enforcement of containment measures leads to the emergence of new variants of the virus – will result in higher mortality and more severe public health outcomes, a weaker recovery, larger job losses, and more business failures (OECD, 2021^[12]). The economic risks of a poor rollout are also heightened by the threat of divergence from developed economies, which, with greater resources, are better placed to vaccinate their populations quickly. As a result, most developed economies will not only benefit from a stronger recovery than Central Asia, but they also will be slower to resume travel, trade and investment in regions where the public health risks are perceived to be higher, because vaccine rollouts are less advanced. This could set back Central Asia's convergence gains of recent years.

As of early August 2021, vaccination campaigns across Central Asia continued to lag those in many OECD and EU countries (Figure 52). While all Central Asian countries had begun their vaccination campaigns, only Kazakhstan, which manufactures the Russian vaccine Sputnik V and its own vaccine, QazVac, had made notable progress, with almost 30% of the population having received at least one dose (Auyezov and Mikheyev, 2021^[13]). This is reasonably close to the world average (24%) but well behind the EU average (60%) and pacesetters such as the UK (67%) (Our World in Data, 2021^[14]). After Kazakhstan, the best performer was Uzbekistan, which had administered at least one dose of a COVID-19 vaccine to around 15% of the population. The remaining countries in Central Asia had vaccinated only a negligible proportion of their populations.

Effective vaccination campaigns in the region face manifold challenges. The first and perhaps biggest issue is the question of supply. Confirmed available doses per person in Central Asia significantly lag other regions. Kazakhstan had reached 0.4 doses per person, the highest ratio in Central Asia, by the end of August 2021, thanks in part to domestic production of Russia's Sputnik V. Kazakhstan also developed its own vaccine, QazCovid-in, which is more widely known as QazVac, and began to ramp up production over the summer (Astana Times, 2021^[15]) (Astana Times, 2021^[16]). However, compared with 6.5 doses per person in the EU, coverage remains low. This divergence exacerbates the risk of a two-speed recovery between the region and developed economies, and is indicative of the global challenge of ensuring equitable access to vaccines. Kyrgyzstan, Tajikistan, and Uzbekistan have received shipments of the

Oxford/AstraZeneca vaccine from COVAX², and Kazakhstan delivered doses of QazVac to Kyrgyzstan at the end of July, but per capita coverage remains very low (Figure 5.2). Kazakhstan and Uzbekistan have also recently procured some vaccines developed in China (GAVI, 2021^[17]; Statistica, 2021^[18]; Duke Global Health Innovation Center, 2021^[19]).

Figure 5. Vaccine procurement and administration in Central Asia



Source: (GAVI, 2021^[20]; Duke Global Health Innovation Center, 2021^[19]; Statistica, 2021^[18]; Our World in Data, 2021^[14])

There are a number of other barriers to the success of the region's vaccination campaigns, including the long-standing issues of underfunding and low administrative capacities (Figure 2), which will affect the ability of governments to administer their vaccination campaigns effectively. Many vaccine candidates require storage solutions that are beyond the logistical capacities of the region (AKI Press, 2021^[21]). Procurement and administration are creating supply-side barriers to vaccination campaigns, but there also appears to be significant societal resistance to vaccination across the region. Responding to low uptake of available doses, governments have begun mandating vaccination for some population groups. On 3 July, the government of Tajikistan introduced a legal mandate that all adults over the age of 18 receive a vaccination, a move that was replicated by Turkmenistan on 7 July, despite the government's insistence that there have been no COVID-19 cases in the country (Neutral Turkmenistan, 2021^[22]; ASIA-Plus, 2021^[23]). However, it is unclear how these mandates will be enforced.

² COVAX is the worldwide initiative aimed at equitable access to COVID-19 vaccines directed by Gavi, the Vaccine Alliance (formerly the Global Alliance for Vaccines and Immunization, or GAVI), the Coalition for Epidemic Preparedness Innovations (CEPI), and the World Health Organization (WHO). COVAX coordinates international resources to enable low-to-middle-income countries equitable access to COVID-19 tests, therapies, and vaccines. For more information: <https://www.who.int/fr/initiatives/act-accelerator/covax>

Strengthening the foundations for a private sector-driven recovery

A longstanding challenge for Central Asia is that despite its remote location, far from the major centres of global demand, it is profoundly dependent on external demand, particularly for commodities and labour. If Central Asian governments are to ensure that they will “build back better” and reduce their vulnerability to future shocks – a stated ambition of many policy-makers – then they must address one of the major barriers to more sustainable, resilient, and inclusive growth: an underdeveloped private sector.

The challenge facing policy-makers in the short-to-medium-term is two-fold. On one hand, as elsewhere, governments must find a way to support fragile private sectors during the ongoing crisis, helping companies survive, modernise (through digitalisation and greening), and recover. They must avoid the unnecessary exit of viable firms, minimising the loss of productive assets and maintaining employment. On the other hand, governments can do much to rectify weaknesses in the business climate, so that firms and entrepreneurs can thrive, create jobs, integrate into global value chains, and increase domestic competition and productivity. Delivering on both these priorities will be crucial to the region’s economic future.

Regulatory complexity and significant implementation gaps, limited access to financial and human resources, the lack of a level playing field, particularly with state-owned enterprises (SOEs), and structural challenges such as poor connectivity and trade facilitation, all render the private sector’s recovery in Central Asia more difficult than in many other areas of the world. The issue of financial support for the private sector is indicative: in Central Asia, credit to the private sector across the region averages 24% of GDP, compared to 134% for OECD members (World Bank, 2020^[4]). At the same time, the region’s governments must contend with issues such as extremely high levels of informality, disruptions to labour migration, and regional disparities, all of which make the design and administration of policy more difficult.

Crises are often moments of abrupt and sometimes painful change, and they have a tendency to reinforce long-term trends more often than reversing them. In addition, most crises highlight long-standing problems, while accelerating trends already under way. COVID-19 is no exception. It has brutally exposed Central Asia’s structural weaknesses – both in terms of its economies and of its socio-health infrastructure – and has led to a contraction of economic activities, a drop in trade, an increase in poverty, and likely an increase in the many socio-economic, gender and spatial inequalities in the region.

At the same time, 2020 was also a year in which governments in the region reacted in many cases with agility and effectiveness to the needs of citizens and businesses. Governments continued to advance their digital agendas, opening new avenues to address many problems that affect the private sector. Intra-regional co-operation, which was growing before the pandemic and which will be crucial to the region’s long-term economic development, has deepened. Among the bodies supporting businesses and public-private dialogue, BIOs have played an important role in assessing the effects of the crisis on firms and proposing solutions; their further involvement in policy-making could support an inclusive economic recovery. If this impetus for listening to the private sector and finding new avenues to support it continues, the COVID-19 crisis and the recovery period could be the moment that governments in Central Asia scale up their efforts, together with BIOs and partners, to address the many issues that rendered the region so vulnerable to the pandemic’s socio-economic effects in the first place.

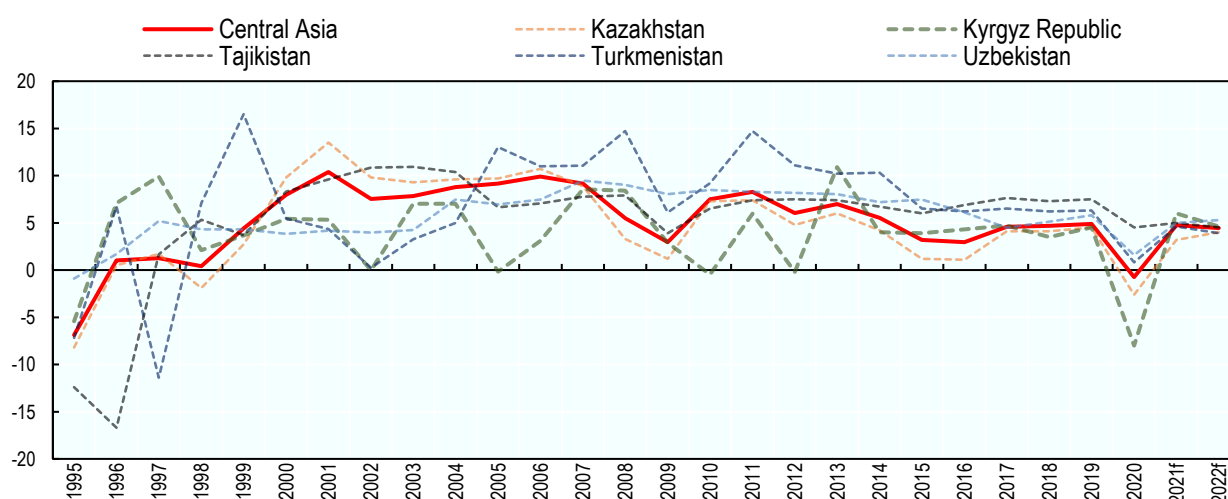
1. Economic impact of COVID-19 in Central Asia

Introduction

The COVID-19 pandemic has arguably been the biggest economic shock to hit Central Asia since its tumultuous first decade of independence (Figure 6). Growth is expected to rebound in 2021, but significant uncertainty on the speed of the recovery remains, given severe fiscal pressures, dependence on the recovery of key markets for exports of goods and surplus labour, and an uneven and slow vaccine rollout (IMF, 2020^[24]). Growth in each of the region's economies – whilst remaining positive – is forecast to be slower in the coming years than in the period preceding the pandemic. Recovery after both the 2008 Global Financial Crisis and the 2014-15 commodity crash led to trend rates below where they had been before the shock. If this pattern is repeated yet again, the region will underperform for years to come, and income convergence will effectively stop. This highlights the need for policies to facilitate a shift in growth models and to help the region regain the momentum it has lost in the wake of successive shocks since 2008.

Figure 6. Long-term real GDP growth in Central Asia

2020 saw the first economic contraction in Central Asia for over two decades, with the recession following a long-term slowdown in real GDP growth



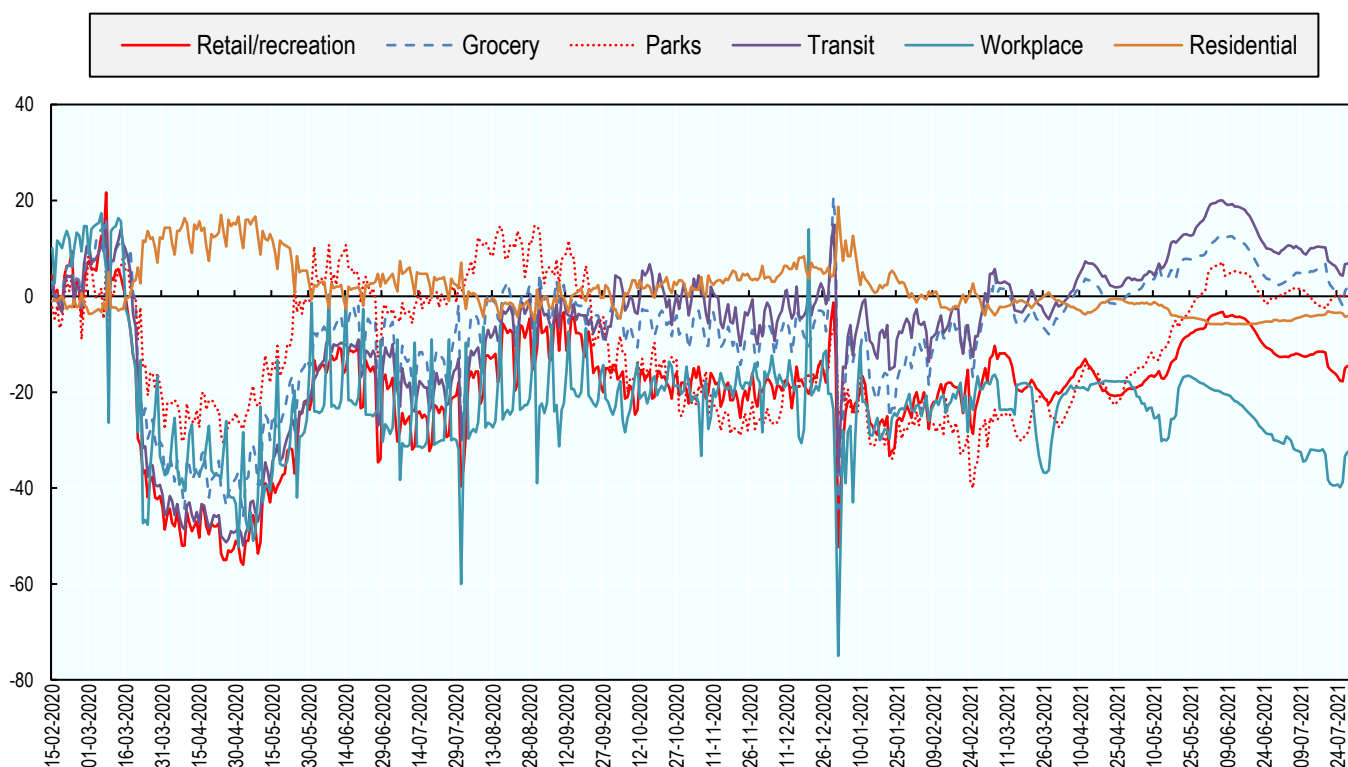
Note: 2021 and 2022 are IMF estimates.

Source: (IMF, 2020^[24]; World Bank, 2021^[2])

In the first quarter of 2021, economic activity remained subdued across Central Asia, though some signs of recovery were beginning to emerge. Data from Google Mobility, which monitors trends in a number of proxies for economic activity – including transit passenger numbers, retail footfall, and workplace activity – show that only public transport edged above the baseline set in early 2020, before the pandemic hit (Figure 7). Other indicators of activity, such as the number of people visiting shops and frequenting their workplaces, remained significantly below the pre-pandemic baseline.

Figure 7. Economic activity in Central Asia: Google Mobility

Activity remains below pre-COVID levels in many areas of the region's economy



Note: Average Google Mobility Report recordings for Kazakhstan, Kyrgyzstan, and Tajikistan. The percentage change is calculated against a 5-week average recorded from 03/01/20-06/02/20.

Source: OECD calculations based on [Google Mobility Reports](#) data.

A similar picture of a hesitant reopening emerges from preliminary data from national statistical agencies and business surveys. The IHS Markit Composite PMI³ for Kazakhstan, which plunged in April 2020 to a record low of 15, remained below 50 a year later (a score of above 50 indicating a monthly increase in output and orders). Managers noted supply chain issues, shortages, increased raw material costs and unfavourable exchange rates contributing to input price inflation (Tengri Partners & IHS Markit, 2021^[25]). In Kyrgyzstan, early data suggest a mixed beginning to the second year of the pandemic. A 20% reduction

³ The Purchasing Managers' Index (PMI) is a monthly indicator compiled by IHS Markit, a US-based market intelligence company, which assesses the overall confidence change of purchasing managers from private sector companies regarding the economic outlook. A PMI above 50 indicates an improvement.

in mining activities amidst ongoing uncertainty at the Kumtor gold mine contrasts with modest growth in the country's service sectors, such as retail trade and hospitality, which endured a particularly challenging period in 2020 (National Statistical Committee of Kyrgyzstan, 2021^[26]).

An uneven vaccination campaign is one of the most significant risks to recovery

A number of factors suggest that governments in the region will face significant headwinds and fiscal pressures as they seek to chart a course out of the current crisis and support private sector recovery. Perhaps most pressing is the risk of new outbreaks. At the time of writing (August 2021), the public health situation remains precarious, not only in the region, but worldwide. Vaccine rollout has been slow, and there remains a risk that variants like Delta – which can spread faster and sicken more people than the original coronavirus – could lead to new outbreaks. This means Central Asia's governments will have to balance fluctuating health risks against the socio-economic cost of additional containment measures, which have been significant, particularly in places where economic activity relies heavily on informal activity and/or proximity services.

Policy responses to the crisis have been broadly similar to those of OECD countries but differ in scale, duration, and effectiveness

Policy responses in Central Asia, first to contain the spread of COVID-19 and then to mitigate its socio-economic impact, have been similar to those observed in OECD countries, with the size of interventions reflecting the fiscal capacity of governments as well as their perception of public health risk. All Central Asian countries adopted stringent restrictions on foreign travel starting Q1 2020, with many of these restrictions remaining in place through the summer of 2021 (except in Kyrgyzstan, which lifted most restrictions in April 2021). Kazakhstan, Kyrgyzstan, Turkmenistan, and Uzbekistan also adopted internal mobility restrictions in March 2020. These ended first in Uzbekistan (June 2020) and Kyrgyzstan (October 2020), and are ongoing in the others besides a brief reprieve over summer 2020 in Kazakhstan. Tajikistan, however, had a brief internal travel ban only over summer 2020 (University of Oxford, 2021^[5]). The Turkmen authorities maintain that there are no cases in the country, but Turkmenistan has kept *internal* travel restrictions longer than any other Central Asian country (these restrictions remained in place at the time of writing in August 2021), which implies tacit acknowledgement that COVID-19 is circulating in the country and could spread even without foreign travel.

Economic responses in Kazakhstan, Kyrgyzstan, Uzbekistan, and, to a lesser degree, Tajikistan were also generally in line with those seen in OECD countries (Table 1). Income support, including price controls, strengthened the social safety net. To keep businesses afloat, policy-makers increased the liquidity and credit lines for businesses through dedicated funds and commercial banks. Some also supported deferral of loan repayment from banks. Taxation has been another key policy lever, both in terms of policy and administration, with governments postponing tax declarations, deferring payments, suspending audits, and/or exempting firms from social contributions, among other measures. Moratoria on business inspections have also been widely used throughout the region. Digitalisation is another policy tool some governments used to continue provide services (see Chapter 2). Turkmenistan is the exception here: it has not announced any additional spending package, because it does not acknowledge COVID-19 on its territory.

Table 1. Overview of fiscal policy responses in Central Asia, 2020 and QI-II 2021

Country	Total response (% GDP)	Policy response	Extent	Jan '20	Feb '20	Mar '20	Apr '20	May '20	Jun '20	Jul '20	Aug '20	Sep '20	Oct '20	Nov '20	Dec '20	Jan '21	Feb '21	Mar '21	Apr '21	May '21	Jun '21	
Kazakhstan	7.3% 4.4% on-budget 2.9% liquidity/ off-budget	Lockdown	Large																			
		Business closures	Large																			
		Income support	Large																			
		Tax measures	Large																			
		Credit support	Large																			
Kyrgyzstan	6.1% Entirely on-budget; no liquidity support	Lockdown	Large																			
		Business closures	Large																			
		Income support	Some																			
		Tax measures	Large																			
		Credit support	Large																			
Tajikistan	3.5% 3.0% on-budget 0.5% liquidity/ off-budget	Lockdown	Limited																			
		Business closures	Limited																			
		Income support	Large																			
		Tax measures	Limited																			
		Credit support	Limited																			
Turkmenistan	0%	Lockdown	None																			
		Business closures	Limited																			
		Income support	None																			
		Tax measures	None																			
		Credit support	None																			
Uzbekistan	5.7% 4.4% on-budget 1.3% liquidity/ off-budget	Lockdown	Large																			
		Business closures	Some																			
		Income support	Large																			
		Tax measures	Large																			
		Credit support	Some																			

Notes: Measures indicated in green have been implemented by the country, measures indicated in red have not. IMF estimate for total fiscal response as of July 2021. Lockdown means national level. Business closures refers to government-enforced temporary closures, not permanent closures resulting from economic conditions. Income support includes employment, rent assistance, price controls, etc. Extent is a qualitative assessment or resourcing and breadth based on OECD reports. Sources: (IMF, 2021^[27]; OECD, 2020^[1]; Government of Kazakhstan, 2020^[28]; Kazak Agency for the Regulation and Development of the Financial Market, 2020^[29]; Interfax, 2020^[30]; Kyrgyz State Tax Service, 2020^[31]; Kyrgyzstan Jogorku Kenesh, 2020^[32]; Kyrgyzstan Cabinet of Ministers, 2020^[33]; Kyrgyzstan Cabinet of Ministers, 2020^[34]; University of Oxford, 2021^[5](Yusufzoda, 2020^[35]; Aytakov, 2020^[36]; President of Uzbekistan, 2020^[37])

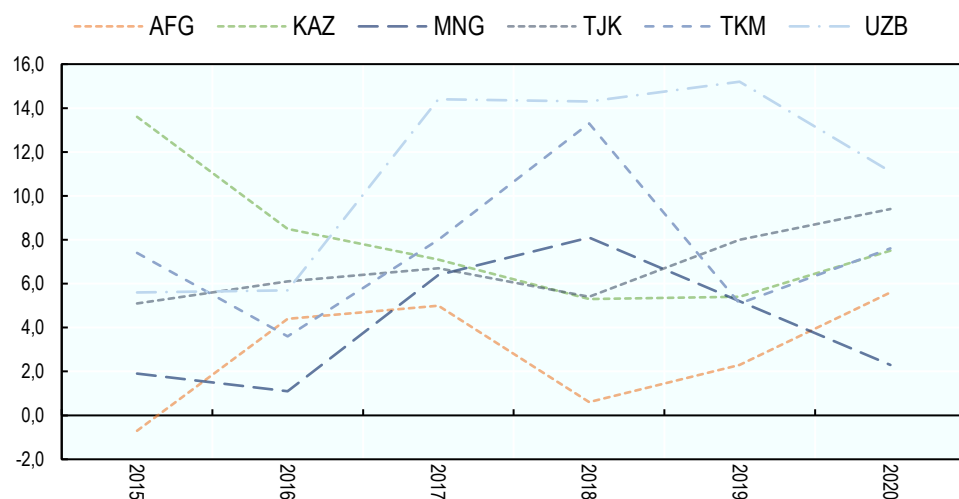
Inflation, debt dynamics, and public revenue management pose risks to macro-economic stability

Expansionary monetary policy has come amid continued inflation

Central banks pursued expansionary monetary policies to stabilise and support economic activity. Broad money grew significantly in 2020, with double-digit percentage increases in all economies except Turkmenistan (7.5%, down from 12.9% in 2019). The largest increase was 23.2%, in Kyrgyzstan, followed by 18.5% in Tajikistan, 17.9% in Uzbekistan and 16.9% in Kazakhstan (IMF, 2020^[24]; OECD, 2021^[38]). At the same time, central banks intervened to stabilise national currencies, with a 19% depreciation of the Kyrgyz som possibly contributing to the country's significant increase in inflation – partially imported due to rising food and basic commodity prices across the region. Other central banks across the region took measures to increase exchange rate flexibility and allow their currencies to depreciate throughout the year. In Q2 2020, the Kyrgyz som, Uzbek sum, Kazakh tenge, and Tajik somoni all fell significantly against the US dollar. The official exchange rate of the Turkmen manat remained unchanged, though an unofficial rate of around 30 manat to the dollar, almost ten times the official peg, implies a significant overvaluation (Xe, 2021^[39]). Tellingly, the market rate for the Turkmen manat was about 18:1 in late 2019, implying that the crisis has had a severe impact on demand for foreign currency. While weaker exchange rates could offer some relief to domestic exporters, they also risk increasing the region's debt burdens and reducing the purchasing power of households and firms across the region's economies.

Figure 8. Inflation dynamics in Central Asia

Change in consumer price indices to previous December.



Note: Data for Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan are from national statistical offices; data for Turkmenistan is provided by the IMF.

Source: (National Statistics Committee of Uzbekistan, 2021^[40]) (National Bank of Tajikistan, 2021^[41]) (National Statistical Committee of Kyrgyzstan, 2021^[42]) (National Statistical Committee of Kazakhstan, 2021^[43]) (IMF, 2021^[44])

Macroeconomic indicators suggest that uncertainty will continue. Inflation was already relatively high in most of the Central Asia's economies prior to the crisis, and averaged 8.4% in 2020 compared to an

average of 4.9% in emerging markets and developing economies and an OECD average of 3.4% (IMF, 2020_[24]). It is important to understand the drivers of inflation in the economies of Central Asia. Whereas much of the policy discussion in OECD countries has been on the question of rising inflation after a period of stability, as well as the concomitant issue of central bank interest rate increases, the situation in Central Asia is somewhat different. Inflation in the region remains generally elevated due to the effects of higher prices for – often imported – food and other inputs, as well as exchange rate pass through (Poghosyan, 2021_[45]) (IMF, 2020_[46]) (IMF, 2020_[47]). In a context where banking systems remain relatively weak, with high domestic dollarisation, much external debt denominated in dollars and underdeveloped local capital markets, the impact of monetary policy interventions on inflation may be lower. While the impact of the pandemic may have aggravated these structural weaknesses, it did not cause them, and relatively high, if declining, levels of inflation are likely to persist in the coming years.

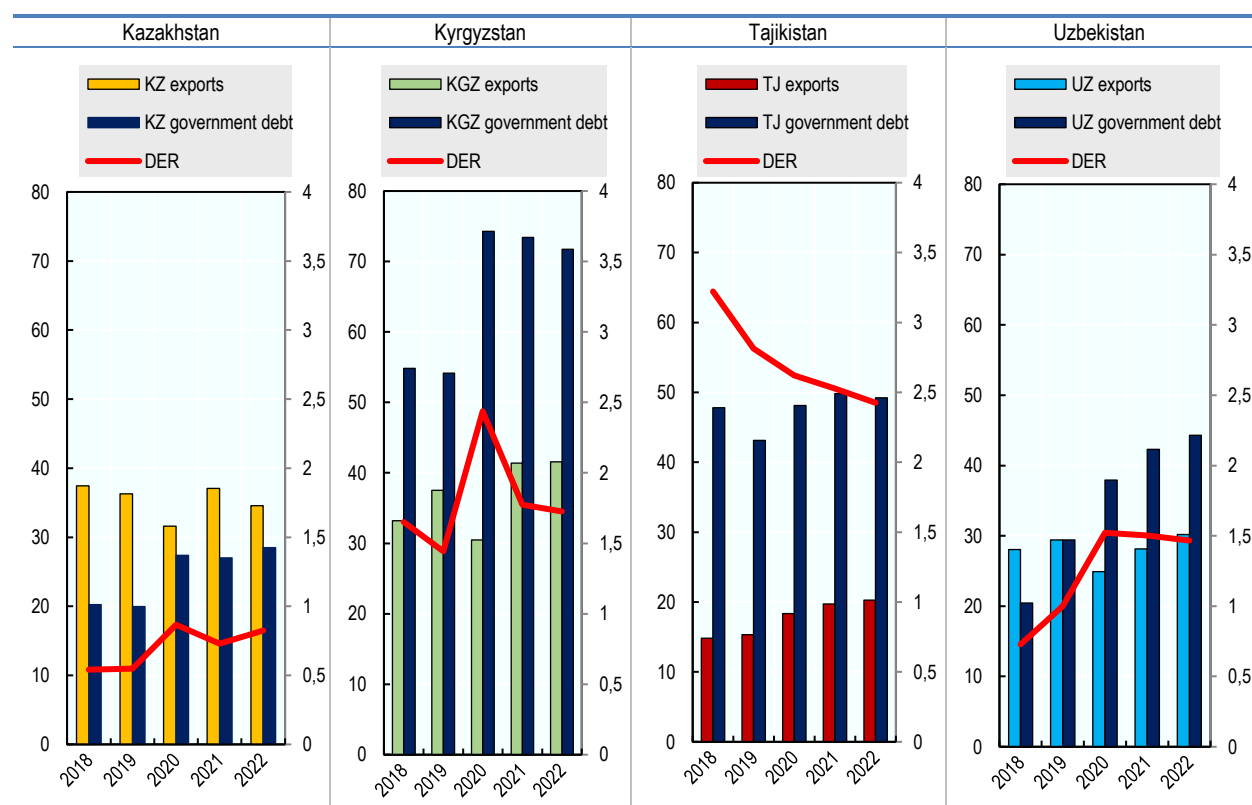
The extent to which higher rates of inflation in Central Asia will persist is unclear, but data from the first half of 2021 from Kazakhstan and Kyrgyzstan, and early 2021 data in Tajikistan suggest that inflationary pressures remain high, driven in large part by higher prices for imported foodstuffs and basic products. Only in Uzbekistan does the situation seem stable. If inflation remains high, and if a new negative shock affects the region, it seems unlikely that central banks would make further reductions to policy rates to support credit to households and firms, since this would entail a significant risk of accelerating prices growth. For countries that have entered international financial markets, such as Kazakhstan and Uzbekistan, rising inflation would negatively weigh on investors' expectations and could lead to increased volatility in their currencies.

Policy-makers face debt sustainability and public finance management challenges

Debt and public finances will be a key concern for Central Asia's policy-makers in the months and years ahead. As in many OECD countries, most governments in Central Asia undertook significant fiscal policy interventions to mitigate the impact of the crisis on the private sector and households. While these interventions – including tax deferrals and breaks, payment holidays, rate reductions and subsidised lending – helped save many viable businesses and the jobs they support, they also reduced tax revenues and increased public debt across Central Asia (OECD, 2020_[11]). In 2020, regional public debt soared 20% above the previous decade's average, and in Kyrgyzstan and Tajikistan, it reached 71% and 49% GDP respectively (Figure 9). However, debt sustainability in Central Asia needs to be considered mainly as an issue of state revenue management and exposure to a limited number of creditors, rather than an issue only of debt levels.

Figure 9. Debt sustainability in Central Asia

Kyrgyzstan and Tajikistan have the highest levels of debt distress risk in Central Asia, indicated by higher debt-to-export revenue ratios (DER, rhs), whereas government and publicly backed borrowing is lower in Kazakhstan and Uzbekistan.



Note: (1) Exports refer to total exports of goods and services, expressed as a percentage of GDP based on the nominal GDP of the given year. (2) Government debt refers to all government or publicly backed liabilities, both internal and external, and is expressed as a percentage of GDP. (3) The debt-to-export revenue (DER) is a commonly used indicator of sustainability of debt (rhs), expressed as a simple ratio of export earnings to outstanding debt; a lower number indicates that outstanding liabilities can be settled more quickly using export earnings, a higher number indicates that it would take longer to settle outstanding liabilities. (4) The assessment of debt distress is taken from debt sustainability analyses compiled by the IMF in their most recent country reports for Kyrgyzstan, Tajikistan, and Uzbekistan.

Source: (IMF, 2021^[44]) (IMF, 2019^[48]) (IMF, 2020^[46]) (IMF, 2020^[47]) (IMF, 2014^[49])

The IMF considers the risk of debt distress in Kyrgyzstan and Tajikistan, two countries with particularly high external debt liabilities, to be moderate and high, respectively. Uzbekistan and Kazakhstan – the two countries in Central Asia that have been most active in sovereign debt markets in recent years – are reckoned to have a low debt distress risk.

In Kyrgyzstan, public debt had been falling in recent years, with the sharp increase in publicly backed liabilities in 2020 due to the government's fiscal interventions to support the private sector, higher levels of social spending, and a marked depreciation of the Kyrgyz som vis-à-vis the US dollar (Figure 9). Despite higher public spending, Kyrgyzstan's public debt is projected to remain below the sustainability thresholds of debt-to-GDP (<55%), debt service-to-exports (<22%), and debt service-to-revenue (<23%) (IMF, 2020^[46]). A gradual shift from external to domestic financing in the coming years could help lower the total level of external debt, though the distress risk will remain moderate.

Tajikistan remains in a substantially more precarious situation, and is assessed by the IMF to be at high risk of debt distress, with the country breaching two sustainability thresholds – present value debt-to-export ratio (<180%) and debt service-to-exports indicator (<15%) – in the baseline scenario of their most recent debt sustainability analysis (IMF, 2020^[47]).

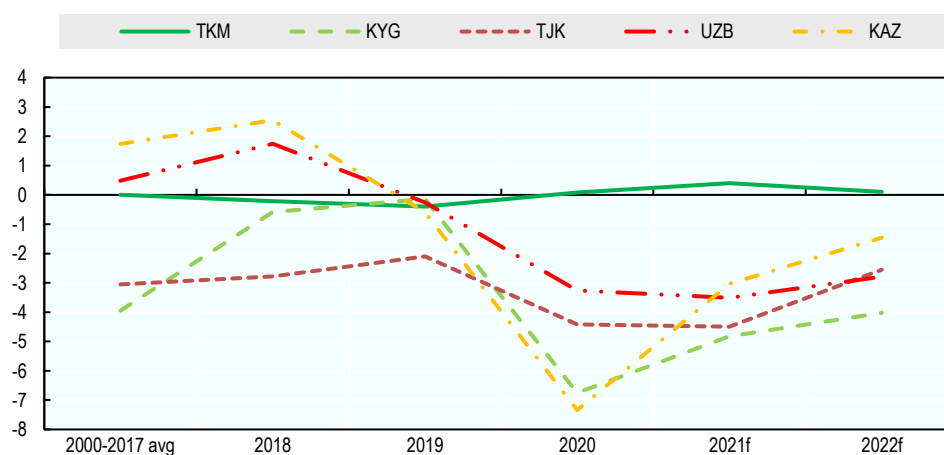
For both countries, the greatest risk to their debt distress is an export shock, with revenues from the export of raw materials integral to their ability to service public borrowing.

The question of debt distress, as well as the need to maintain or increase public investment and support as the economies of Central Asia begin their recovery from the global pandemic, has refocused attention on the need for more sustainable public revenue management. Government revenues have been severely affected by the crisis. VAT revenues were particularly affected, in large part due to the impact of reduced remittances, which will have affected VAT collections on imported goods. Indirect consumption taxes are particularly significant in Central Asia, with income and corporate tax generally making a less important contribution to national finances. For example, VAT income represents on average 33.6% of tax contributions to national budgets in Central Asia (compared to 21.2% in OECD countries), and in 2019 was as high as 50% all tax revenues in Kazakhstan, followed by 41.9% and 34% in Kyrgyzstan and Uzbekistan (Ministry of Finance of Uzbekistan, 2019^[50]) (OECD, 2020^[11]).

The oversized role of indirect taxes therefore means that national finances are particularly sensitive to shocks affecting domestic consumption. The impact in Kyrgyzstan of an almost 25% drop in VAT collection in 2020 is likely to create additional budgetary pressures. That export duties on raw materials represent another major component of public finances in the region adds to a general financial precarity, one that could be mitigated by a more diverse, inclusive tax base. Nevertheless, data from national statistical agencies and tax authorities suggest that only Kyrgyzstan experienced a nominal budget cut (of 13.6%), but the combination of inflation and currency depreciation means that most countries in the region likely had a real-terms cut or only a moderate increase in public spending in 2021 (State Committee on Taxation of Uzbekistan, 2021^[51]; Ministry of Finance of Kazakhstan, 2021^[52]; National Statistical Committee of Kyrgyzstan, 2021^[53]). While Turkmenistan does not publish a detailed budgetary breakdown, the 2021 state budget implies a 6% reduction in spending on the previous year. (State Information Agency of Turkmenistan, 2021^[54]). The overvaluation of the Turkmen manat and inflation also imply a more significant real reduction in public spending.

As mentioned above, given the important role of taxes on mineral goods – whether through excise taxes or on international firms and SOEs operating in extractive sectors – persistently low and volatile hydrocarbon and other commodity prices will continue to have considerable revenue impact on Central Asia's economies. General government fiscal balances across the region have been driven into negative territory, and a more sustainable tax base will require new sources of revenue that are not expressly linked to non-tradables, as well as addressing challenges such as offshoring and base erosion (Figure 10) (IMF, 2020^[24]; World Bank, 2020^[55]).

Figure 10. General government fiscal balances in Central Asia (% GDP)



Note: 2000-17 average for Turkmenistan unavailable.

Source: (IMF, 2020^[24])

It is important to note that the ability of Central Asian countries to maintain aggressive debt-financed government spending, as observed in many OECD countries, is fundamentally restricted by the fact that their borrowing costs are relatively high. Kazakhstan, which has been issuing sovereign and corporate bonds since 1996, and Uzbekistan, which more recently entered international debt markets, are the two Central Asian economies in the strongest position vis-à-vis external borrowing costs (Box 1).

Box 1. Central Asia bond overview

The relatively beneficial financing terms of Uzbekistan and Kazakhstan on international financial markets augur well for their ability to pursue a more expansionary budgetary policy in the years ahead. Uzbekistan issued a USD 1bn sovereign Eurobond in 2019, the country's first ever; half was issued in a 10-year bond that, as of Q2 2021, was trading at around 111 cents-on-the-dollar. This means that the original annual interest rate of 5.375% had fallen to an effective rate of around 3.6%, lowering borrowing costs for Tashkent. The equivalent 10-year bond of Kazakhstan, a more established player in sovereign debt markets, has a similarly beneficial price of 116 cents-on-the-dollar and an effective yield of just 1.1%, significantly below the coupon value of 5.125%, and even below the 1.45% the US Treasury is currently paying for 10-year borrowing.

The situation is markedly different for Tajikistan, where the country's first 10-year Eurobond, which will mature in 2027, is currently trading at 89 cents-on-the-dollar. The price, combined with the significant 7.125% coupon on the bond, suggests that Dushanbe will owe investors over 350 USD million on top of the 500 USD million bond, with limited scope for refinancing. Moreover, Dushanbe intends to return to credit markets in 2021 to raise an additional USD 500m to finance completion of the Rogun Hydroelectric Plant. This represents an unusually large-scale recourse to tradable sovereign debt to finance a single infrastructure project, despite uncertainty about the returns on that investment, which will depend greatly on domestic energy sector reforms as well as the country's ability to increase electricity exports.

Source: (Borse Frankfurt, 2021^[56]; Hess, 2021^[57]; van der Key, 2020^[58]).

Governments' exposure to a limited number of creditors constitutes a further concern with respect to debt sustainability. Kyrgyzstan and Tajikistan's debt distress risk is reckoned to be particularly high due to increased reliance on short-term, expensive, and sometimes resource-backed borrowing. Such collateralised debt can raise the risk of debt unsustainability and distress, and can reduce both future debt-servicing capacity and access to concessional financing (OECD, 2020^[59]; Mihalyi, 2020^[60]; Imam, 2019^[61]; OECD, 2020^[11]). For example, collateralised debt is often off-budget, and there is therefore little information available on the exact amounts and financing terms. This lack of transparency can further lower investor confidence; especially should doubts arise about a borrower's repayment capacity. These types of financing instruments, due to their opaque and often *ad hoc* nature, are also more difficult to restructure. In turn, this could weigh heavily on the long-term health of public finances, further reducing a government's capacity to repay debt or benefit from new concessional lending.

In addition, Tajikistan and Kyrgyzstan's debt is highly dollarised and is particularly exposed to China. In the event of increasing repayment difficulties with respect to loans undertaken to finance infrastructure projects, China could decide to exercise resource collateral rights, as it has done in sub-Saharan Africa (Mihalyi, 2020^[60]). In 2020, Tajikistan and Kyrgyzstan benefitted from the G20 Debt-Service Suspension Initiative (DSSI), the purpose of which was to allow low-income countries meet their social spending objectives throughout the pandemic (Ziayev, Seitz and Rajabov, 2020^[62]). Yet conditions on Tajikistan and Kyrgyzstan's debt obligations to China have at best been only partially reduced, even though China is a signatory of the initiative for debt owned by its two official bilateral creditors (Eximbank and CIDCA); so far, China has not acceded to the countries' request for debt write-offs. While information on Chinese debt relief and suspension remains scarce, Tajikistan does appear to have benefitted from USD 40 million debt relief from China under the DSSI in 2020, and is still seeking additional debt relief from China. However, Kyrgyzstan's requests seem to have been unsuccessful, and the country left the DSSI despite remaining eligible in 2021 (China-Africa Research Initiative, 2021^[63]). The exact amounts and terms of China-held debt (both official bilateral loans and alternative loans channelled through state-owned enterprises (SOEs)) are unclear. If China declines to write off a portion of Tajikistan and Kyrgyzstan's debt, revenue collection and the ability to service other outstanding loans in both countries will be further weakened (OECD, 2020^[64]; van der Key, 2020^[58]; Hurley, Morris and Portelance, 2018^[65]).

As Central Asia's governments seek to secure long-term, sustainable growth, the size and scope of the economic downturn and constrained fiscal margins make ensuring the sustainability of public finances and debt servicing one of the most pressing policy issues. The most immediate concern is that this setting may create pressure for premature fiscal tightening at a time where economies may need sustained investment and stimulus to support the recovery. Managing this balance in Central Asia will be one of the key challenges facing policy-makers in the coming months and years.

Trade flows and supply-chains have been disrupted, while the outsized role of extractive exports in certain economies has had profound consequences

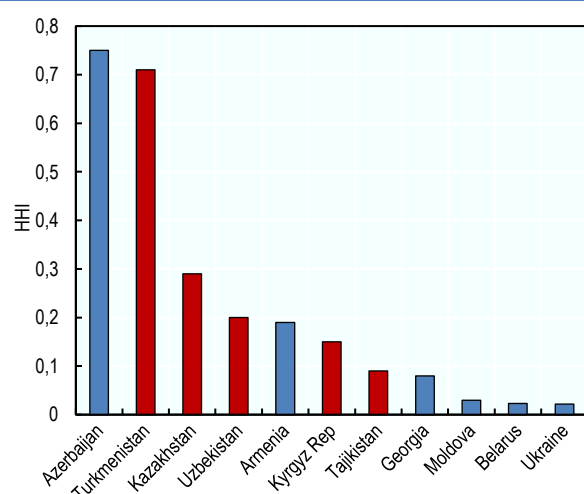
With the exception of Uzbekistan, the economies of Central Asia, which are relatively small and in most cases fairly undiversified, depend heavily on foreign trade. The ratio of trade turnover to GDP across the region averages 65%, higher than the 58% OECD average (World Bank, 2020^[66]). To some extent, trade dependence is a natural concomitant of market size – other things being equal, smaller countries tend to trade more. In Central Asia, however, trade integration is rendered all the more difficult by low population density, remote location and infrastructure bottlenecks, as well as by numerous policy barriers that serve to amplify the “distance penalty” that exporters in the region face on account of geography (ITF, 2019^[67]). Weaknesses in the institutional environment impede private sector growth, so the development and export

of high-value products remains limited. Instead, a small range of primary commodities dominates export baskets (Figure 11.1). Therefore, the impacts of the pandemic on the global economy, including reduced demand and logistical disruptions, had severe consequences for trade in the region.

Figure 11. Export diversification in Central Asia

The region's export products are undiversified and subject to price volatility.

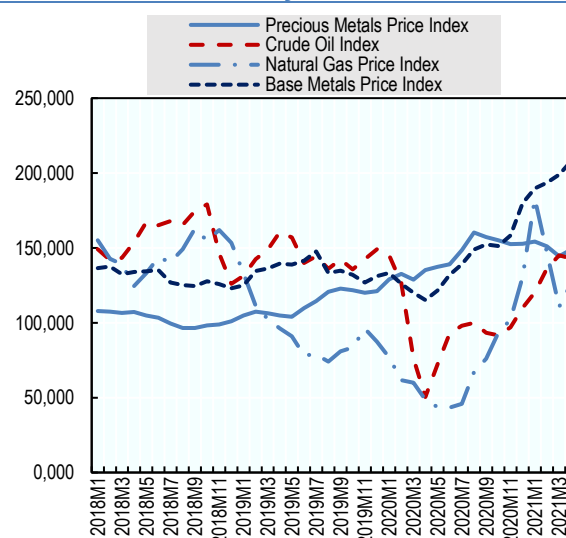
Figure (11.1) Central Asia's export baskets are extremely concentrated



Note: The HHI is a measure typically used to gauge market concentration and the competition between firms in a given sector. The measure is applied here instead to export concentration. This shows the extent to which exports of a given country are concentrated by using the sum of the squared shares of each exported commodity. The range is 0 to 1.0, with 0 denoting an even spread of exports, and 1 denoting a single exported commodity.

Source: (OECD/WTO, 2019^[68])

Figure (11.2) A number of Central Asia's key export products saw significant price volatility in 2020



Note: The precious metals index includes gold, silver, palladium and platinum price indices; the crude oil index is a simple average of three spot prices (Brent, WTI and Dubai Fateh); the natural gas index includes European, Japanese and American natural gas price indices; the base metals price index includes aluminium, cobalt, copper, iron ore, lead, molybdenum, nickel, tin, uranium and zinc price indices. For all indices, 2016 data is set to 100.

Source: (IMF, 2021^[69]).

While the export baskets of Central Asia's economies may be limited, the region's trading community comprises a multitude of different actors. The impact of trade disruptions was therefore multi-faceted, requiring a range of policy interventions. On the one hand, governments derive significant revenues from the export of primary commodities, the value of which fluctuated dramatically throughout 2020 and the export of which is often controlled by SOEs or a small number of large firms (Figure 11). In Kazakhstan, for example, the oil industry accounts for 41.8% of all tax revenues, including 97.9% of export taxes (OECD, 2020^[70]). Export concentration and the implicit vulnerability this implies for public finances is therefore intrinsically linked to the region's diversification agenda, the importance of which the crisis has reinforced.

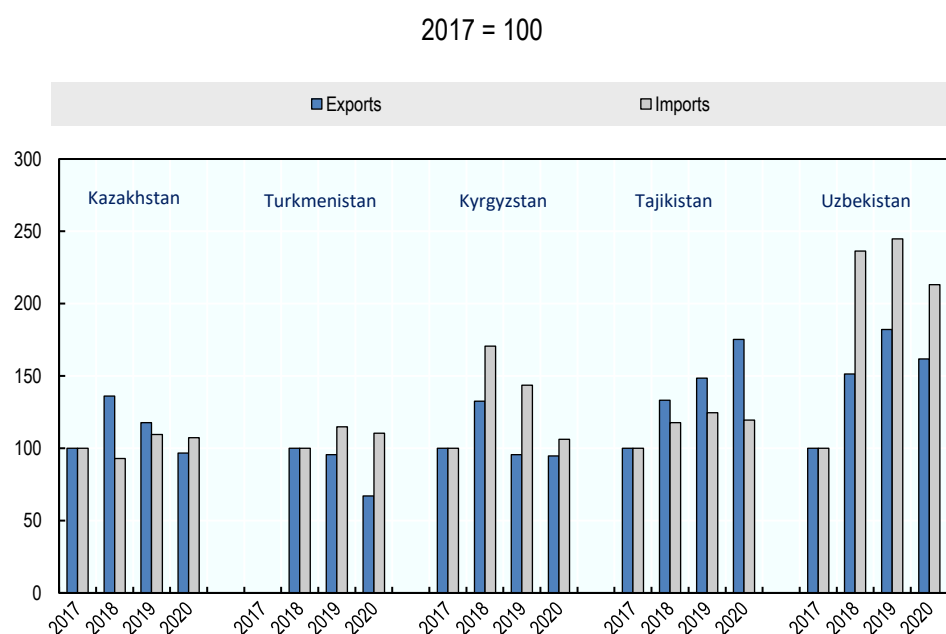
That said, states and SOEs are not Central Asia's only exporters, and the disruptions of 2020-21 have profoundly affected the operations of thousands of SMEs and individual entrepreneurs for whom trade – in both goods and services – is an important aspect of their activity. These firms may not contribute the

same level of tax revenues as large commodity-exporting enterprises, but they contribute significantly more to employment and opportunities for diversification. In Uzbekistan, for example, where SMEs accounted for about 54% of growth and 74% employment in 2020 (a decrease of 0.3% and 2.4% from 2019), SMEs are active in only one of the top three export sectors, services, while the other two – gold and natural gas – see large SOEs be the main exporters. Natural gas exports from Uzbekistan caved by 73% in 2020 following a sharp reduction of demand from China, but the impact on revenues was partly offset by a 16.7% increase in gold exports (National Statistical Committee of Uzbekistan, 2021^[71]). By contrast, service exports fell 42%, and the contribution of SMEs to exports fell from 27% to 20.5%. The share of SMEs in imports also fell, from 61.6% to 51.8% (National Statistical Committee of Uzbekistan, 2021^[72]). An October 2020 survey showed that more than a third of exporting SMEs in Uzbekistan reported a steep drop or complete cessation in their exports. Firms that have been unable to move to remote working arrangements, often due to connectivity and infrastructure issues, were the most severely affected (CERR & UNDP, 2021^[73]; OECD, Forthcoming^[74]).

Uzbekistan's trade decline reflects the disruption of trade flows that occurred as Central Asian states progressively closed their borders and restricted internal movement of people and goods to stem the spread of COVID in early 2020. These value chains – as well as the availability of domestic goods and the concomitant question of food security – were further imperilled by border restrictions imposed by China, Iran and Russia. In particular, exports from most countries in Central Asia to China, a crucial destination for many exporters in the region, fell sharply (Figure 13.2). Some important sectors – for employment if not value added – such as petrochemicals and garments may continue to be affected by both lower global demand and recurrent restrictions on the movement of labour and goods if vaccination levels remain low or if there are new waves of mass infections. In the short-to-medium-term, lower trade has reduced consumption, but equally important are long-term risks to the manufacturing competitiveness of a region where connectivity and regulatory barriers already create significant costs.

The value of exports of goods and services in 2020 fell in almost all Central Asian economies, with Turkmenistan reporting the greatest decline, at 30%. Only Tajikistan registered an increase in the value of exports, due in part to the rising value of precious metals throughout the year. The fall in export revenues combined with lower remittance inflows also led to a decrease in the import of goods and services in each country, having the effect of slightly narrowing current account deficits in all the region's countries except Tajikistan, where the deficit remained unchanged year-on-year.

Figure 12. External sector indicators Central Asia (2017-2020)



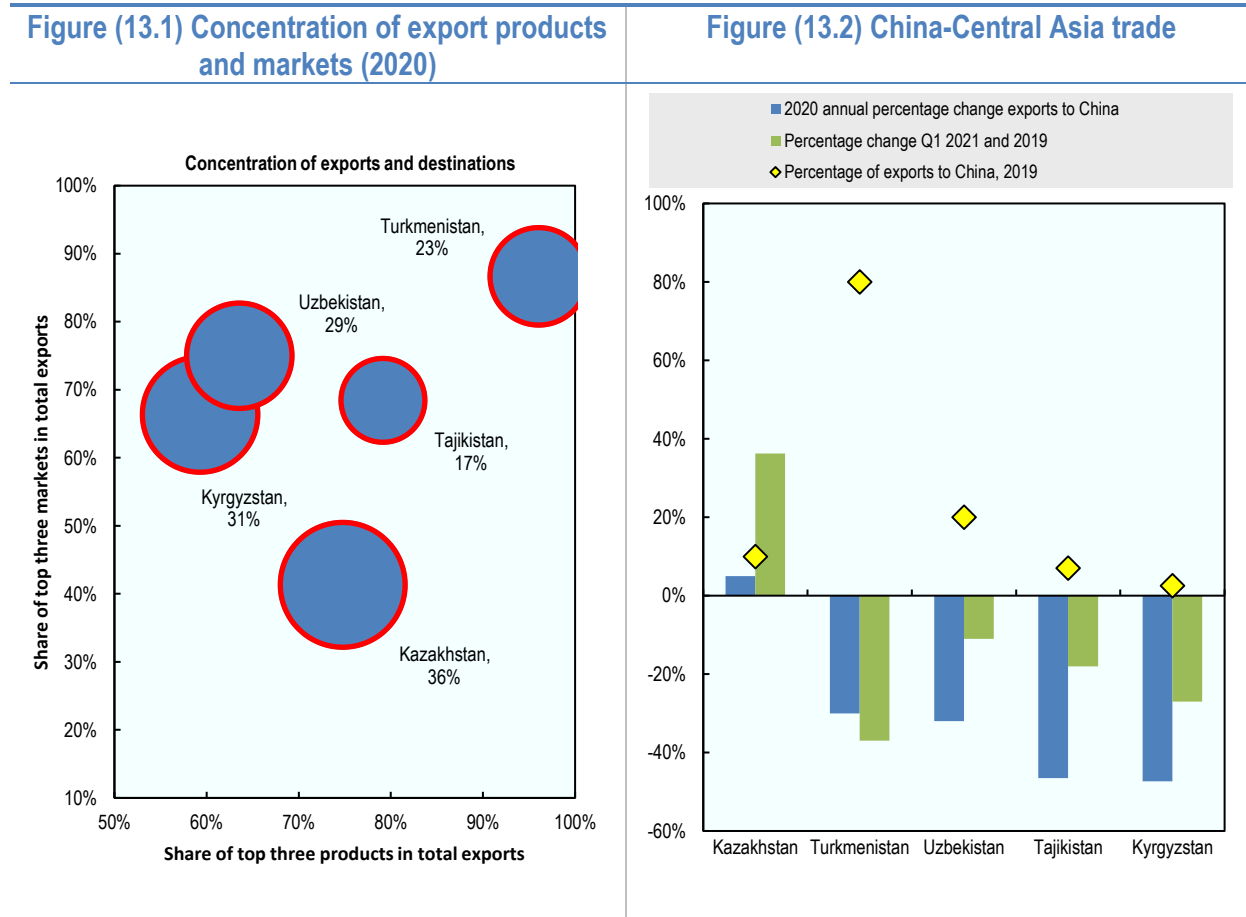
Note: Changes in imports and exports are measured as percentage change from imports and exports in billions of current USD. The reference year is 2017, except for Turkmenistan where data is missing, and 2018 is taken as year of reference.

Source: (National Statistical Committee of Uzbekistan, 2021^[71]; Agency for Strategic planning and reforms of the Republic of Kazakhstan Bureau of National Statistics, 2021^[75]; National Statistical Committee of the Kyrgyz Republic, 2021^[76]; IMF, 2020^[24]) NB: IMF provides data from Tajikistan and Turkmenistan for this figure.

The economic impact of COVID-19 in Central Asia was compounded by falling global oil prices and the application of OPEC+ cuts. The impact on Kazakhstan's public finances was particularly profound, with the April 2020 collapse to 20 USD per barrel illustrating the vulnerability of the country's fiscal position given that break-even fiscal and external positions necessitated prices of 112.8 and 77.8 USD per barrel in 2020 (IMF, 2020^[24]). In Uzbekistan, by contrast, the rising value and volume of exports helped partially offset the negative impact of the pandemic on its trade balance, though exports nevertheless fell by 18% in 2020, while total non-gold exports fell by 29% (Uzbekistan State Statistical Committee, 2021^[77]). The impact of the crisis on external trade also demonstrated the vulnerability of having a narrow range of trading partners, something that is true for a number of Central Asia's economies (Figure 13.1).

Figure 13. Trade concentration in Central Asia

Central Asia's economies have both undiversified export baskets and limited trading partners. Exports to China, one of the region's biggest trading partners, have fallen significantly since the beginning of the pandemic.



Notes: In the chart on the left, the percentage next to each circle represents the share of exports in GDP, signifying the relative importance of external trade to each country. *The figure for Turkmenistan would likely be significantly higher if adjusted for the market exchange rate.

Source: (Customs Agency of the People's Republic of China, 2020^[78]), (IMF, 2020^[24])

In Turkmenistan, for example, over 90% of exports are hydrocarbons. The country's 30% fall in exports to China is likely to create far more immediate pressures than Uzbekistan's 30% decline, given that over 80% of Turkmen exports are destined for China compared to 20% of Uzbekistan's (Figure 13.2). While elsewhere China-destined exports quickly recovered, in Q1 2021, except for Turkmenistan whose export options are constrained by the lack of alternative routes to market for its natural gas in the absence of progress on the TAPI pipeline, an undiversified export profile, and a limited range of trading partners. This will be exacerbated if hydrocarbon prices remain low in the coming years.

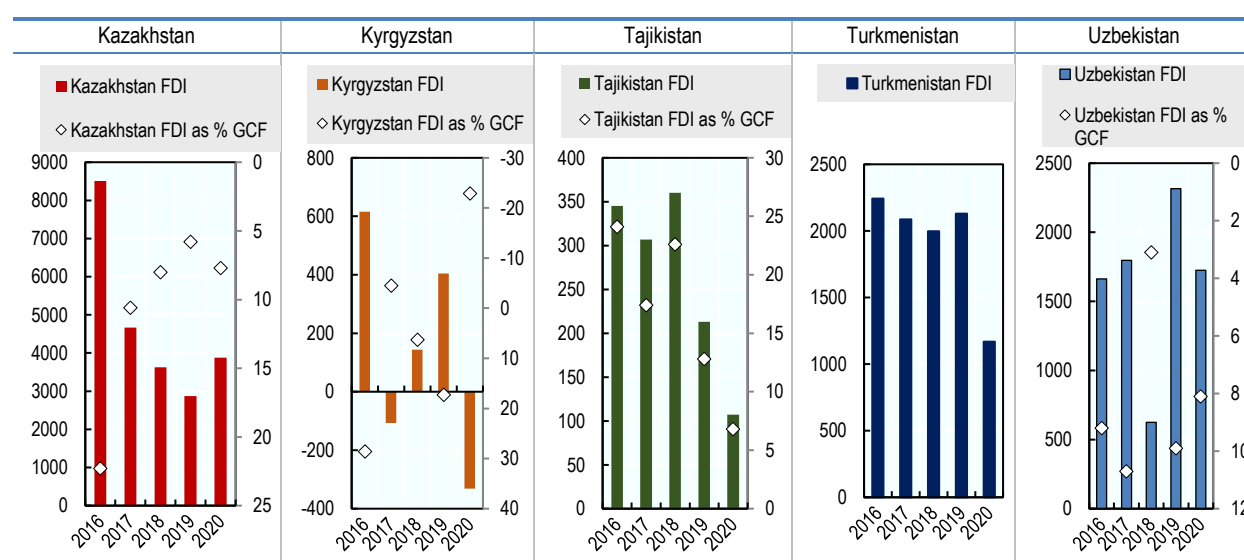
Foreign direct investment has fallen precipitously since the beginning of the pandemic

Capital formation in Central Asia is primarily driven by three sources: public finance, firms' own funds, and foreign direct investment (FDI). With weak banking sectors that struggle to provide significant finance to the domestic private sector (Figure 14), the attraction of more and better quality FDI is recognised by all governments in the region as being crucial to their long-term economic development, yet efforts to do so have so far yielded only limited results.

The global pandemic, however, has severely affected the ability of all countries to attract new FDI. FDI inflows in developed economies crashed by 58% to USD 312 billion in 2020, though this figure is somewhat inflated due to significant fluctuations in intrafirm financial flows and corporate reconfigurations (UNCTAD, 2021^[79]). At the same time, investment in transition economies – taken to be the CIS countries, South East Europe, and Georgia – more than halved in 2020, to USD 24 billion. In contrast, the 18% decline in Central Asia – a decline softened by a 35% increase in net FDI inflows to Kazakhstan, in large part related to new investment in the Tengiz hydrocarbon project – seems at first glance to be relatively mild (Figure 14) (UNCTAD, 2021^[80]).

Figure 14. FDI inflows (USD millions) in Central Asia and FDI as a percentage of GFCF

Only Kazakhstan saw an increase in FDI in 2020



Note: Data on FDI as percentage of GFCF for Turkmenistan is not available

Source: (UNCTAD, 2021^[80]) (UNCTAD, 2021^[81]) (UNCTAD, 2021^[82])

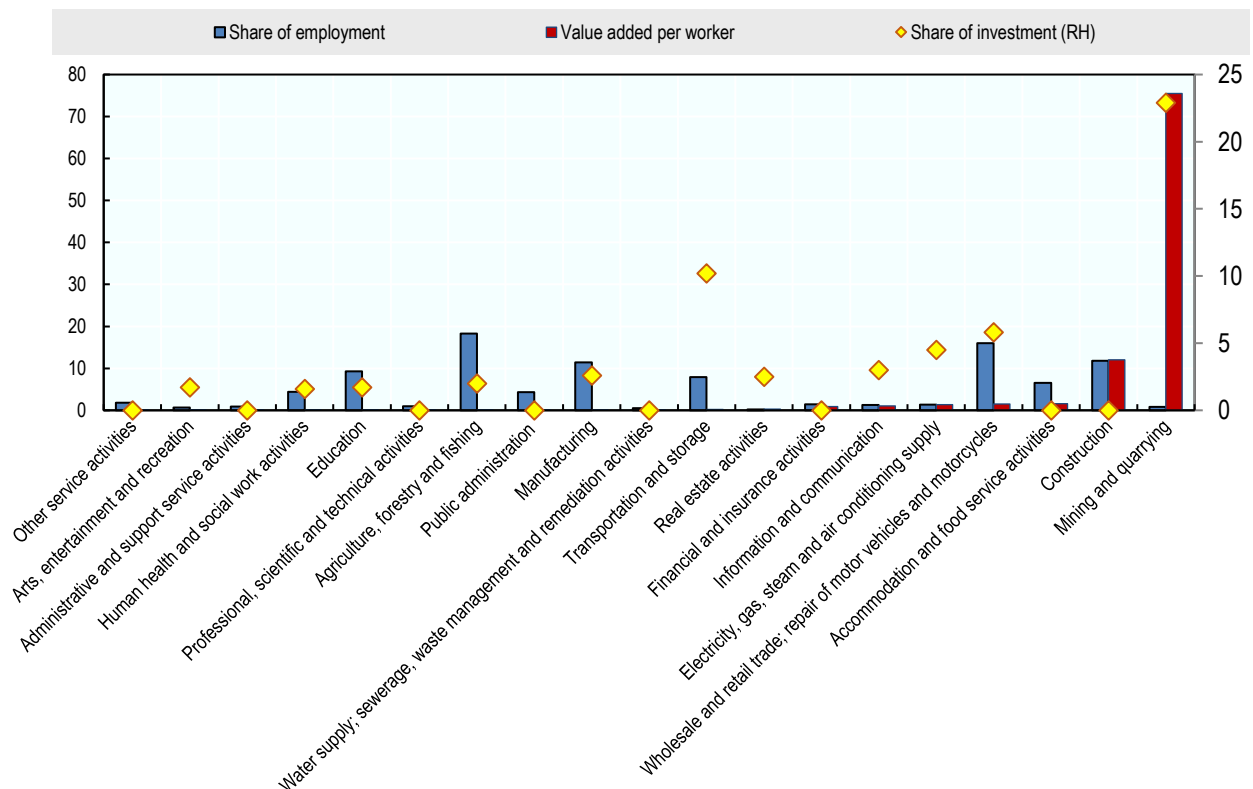
Yet, lower FDI in Central Asia in 2020 follows from a general downward trend since the end of the 2014-15 commodity boom, reflecting the realities of a fragile investment environment, long-standing issues in the region's banking sectors, and an over-representation of extractive sectors in total capital formation. It is worth noting that FDI inflows – as well as greenfield announcements – in the region often appear 'lumpy', since a small number of large investments – often in extractive sectors – can create dramatic peaks and troughs in time-series data. What is important for the region's policy-makers is to facilitate new, more sustainable investment into alternative sectors of the economy, particularly those that are more likely to

contribute to job creation and diversification. While the immediate contraction in FDI flows to Central Asia was less dramatic than in many places, the most significant challenges in attracting FDI are likely to come in the years following the pandemic, as a more competitive global investment climate is likely to be less forgiving of long-standing weaknesses in the region's business climate. It is notable that, whereas FDI in the world's most advanced economies is projected to grow by 20% in 2021, investment prospects for Central Asia are less auspicious, with inflows predicted to begin rising only in 2022 (UNCTAD, 2021^[80]).

In many ways, the crisis has affected investment in Central Asia in much the same way as it has in OECD countries. Sectors most at risk from disruption due to containment measures and mobility constraints are often sectors in which a large number of SMEs operate, accounting for a significant share of employment. However, these firms generally have low productivity and attract low levels of investment. The example of Kyrgyzstan is illustrative here. High-employment sectors such as agriculture (22.3%), retail trade (19.5%), and manufacturing (6.2%) saw investment declines of 15%, 34%, and 38%, respectively. In high-potential sectors such as tourism, the decline was even more dramatic: investment into the food and hospitality sector plummeted by 73% (National Statistical Committee of Kyrgyzstan, 2021^[83]). Amid ongoing uncertainty around the future of the Kumtor gold mine, investment into the country's mining sector – an outsized contributor to productivity gains and the largest recipient of FDI (Fig. 15) – fell by 24% in 2020 (Ibid).

Figure 15. FDI, employment and productivity in Kyrgyzstan

Investment is concentrated in extractive sectors, which levels of productivity are significantly above the national average but employ very few people



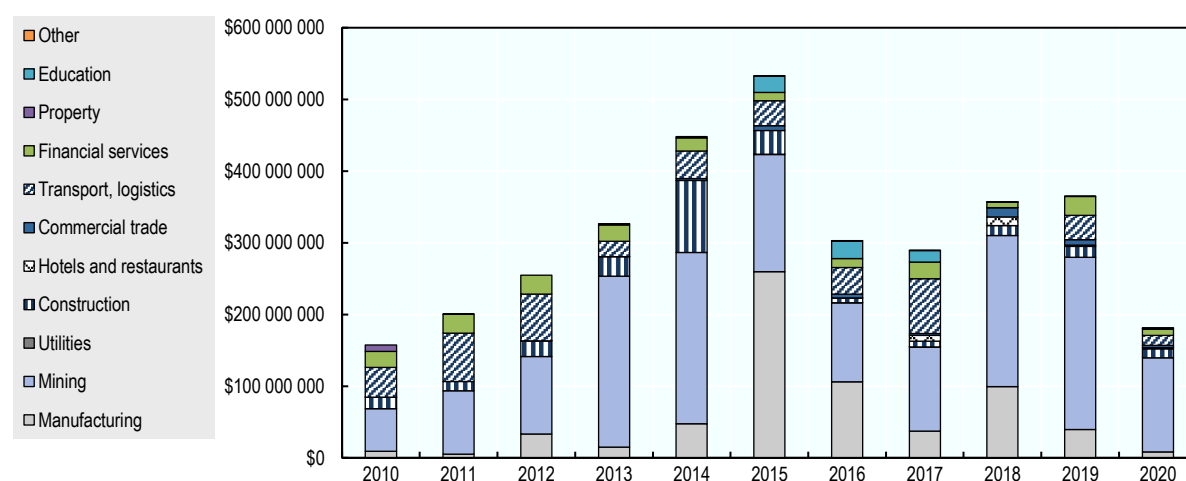
Note: Productivity is given as a percentage of the national average, calculated in value added per worker (Kyrgyz soms). Investment and productivity data are from 2020, employment data are from 2019.

Source: (National Statistical Committee of Kyrgyzstan, 2021^[83]) (National Statistical Committee of Kyrgyzstan, 2021^[84]) (National Statistical Committee of Kyrgyzstan, 2021^[85]).

The situation in Tajikistan is also illustrative of the sustainability-related challenges of investment policy in Central Asia and the extent to which governments' strategies deliver – or can deliver – the job creation, diversification, and higher productivity that they seek to achieve. Investment in Tajikistan continues to be driven by public funds (in 2020 only 25% of investment came from private sources of finance) and FDI inflows remain overwhelmingly concentrated in mining. As the pandemic hit, extractive sectors were amongst the first to experience significant declines in investment activity, so the outsized role of mining in Tajikistan's investment mix contributed to a precipitous collapse in inflows (Figure 16).

Figure 16. Sectoral composition of FDI in Tajikistan (2010-2020)

FDI in Tajikistan remains overwhelmingly concentrated in extractive sectors. In 2020, FDI fell by 51% against the previous 5-year average.



Source: (National Bank of Tajikistan, 2021^[86])

The decline in greenfield investment project announcements and the dynamic of this decline, are worrying in a number of ways. The slowdown in investment showed little sign of improvement in late 2020. Suppressed investment activity will likely continue in 2021. Inflows that have slowed are most marked in sectors that are traditional destinations for FDI, notably petroleum extraction, oil refining, and the production of products such as coke and chemicals. This is, of course, precisely what one would expect in the circumstances. The question is whether Central Asian economies can transcend these traditional areas of focus for investors. At the same time, it is instructive to note that the sectors into which investment has been redirected globally, such as pharmaceuticals and technology, are sectors into which Central Asia has traditionally struggled to attract FDI but that can provide opportunities for diversification (UNCTAD, 2021^[87]).

The disparity in investment inflows into these different sectors is indicative of the fact that large, extractive sector-oriented investors are generally more tolerant of long-standing business climate issues that characterise the economies of Central Asia. Other investors – whose expertise and capital could make a significant contribution to job creation and productivity improvements in Central Asia – are significantly less tolerant. In part, this reflects the fact that extractive-sector companies tend to be quite large and are often able to provide what would ordinarily be public goods for themselves (security, infrastructure, etc.), while operating on a scale that enables them to bargain directly with host governments. But there is more to the

story than mere size or capital intensity, and the conventional typology of FDI (resource-seeking, market-seeking and efficiency-seeking) can be instructive here.

The dynamics characterising resource-seeking FDI in the extraction sector are somewhat similar to those observable in public procurement. The subsoil is state property, the government knows what it wants and so does the investor. The government's task is to choose among competing investors – in effect, competing service-providers – for more or less the same service, the extraction of the primary resource. The chosen investor is supposed to deliver what it and the government agree *ex ante*. Often, there is little trust, because the government sees the investor as keen to exploit a resource that belongs to the state, but the investor is needed for his capital, expertise, etc. Even when trust is low, agreement can often be reached because the potential paybacks are high and the major variables involved are well understood.

Market- and efficiency-seeking investments in other sectors tend to be more exploratory and are therefore more closely linked to policy. There is much less knowledge *ex ante* about the potential investment's viability and profitability. Investors generate new opportunities rather than competing for pre-existing ones. The government, for its part, has to be far less risk-averse and ease restrictions. This entails willingness to trust, rather than control, foreign investors. The conviction that the investor is there to exploit local resources, and must therefore be subject to close scrutiny at every step, will impede potentially productive investment. Moreover, when foreign investors are smaller, they are more likely to rely on general framework conditions for business and investment rather than bargain one-on-one with the state for tailored concessions or production-sharing agreements. They are also less likely to have the internal resources to make up for deficits in public goods provision. This implies that these other forms of FDI will depend on the overall business environment far more than investment in large-scale resource extraction.

Socio-economic inequality in Central Asia

The impact of COVID-19 is likely to have aggravated economic and social inequality

Most employment in Central Asia is in low-productivity activities, both formal and informal (as noted above in reference to Kyrgyzstan). The most productive sectors – often capital-intensive extractive industries – employ comparatively few people. Large imbalances in productivity and employment across sectors in Central Asia's economies are indicative of stalled diversification – the limited change in sectoral employment over the past twenty years reflects this – and speak to the interconnectedness between diversification and long-term social stability. Central Asian economies need more diverse production structures not only to reduce vulnerability to commodity-price fluctuations but also to create more and more productive jobs for their growing populations. Diversification is essential to inclusive growth.

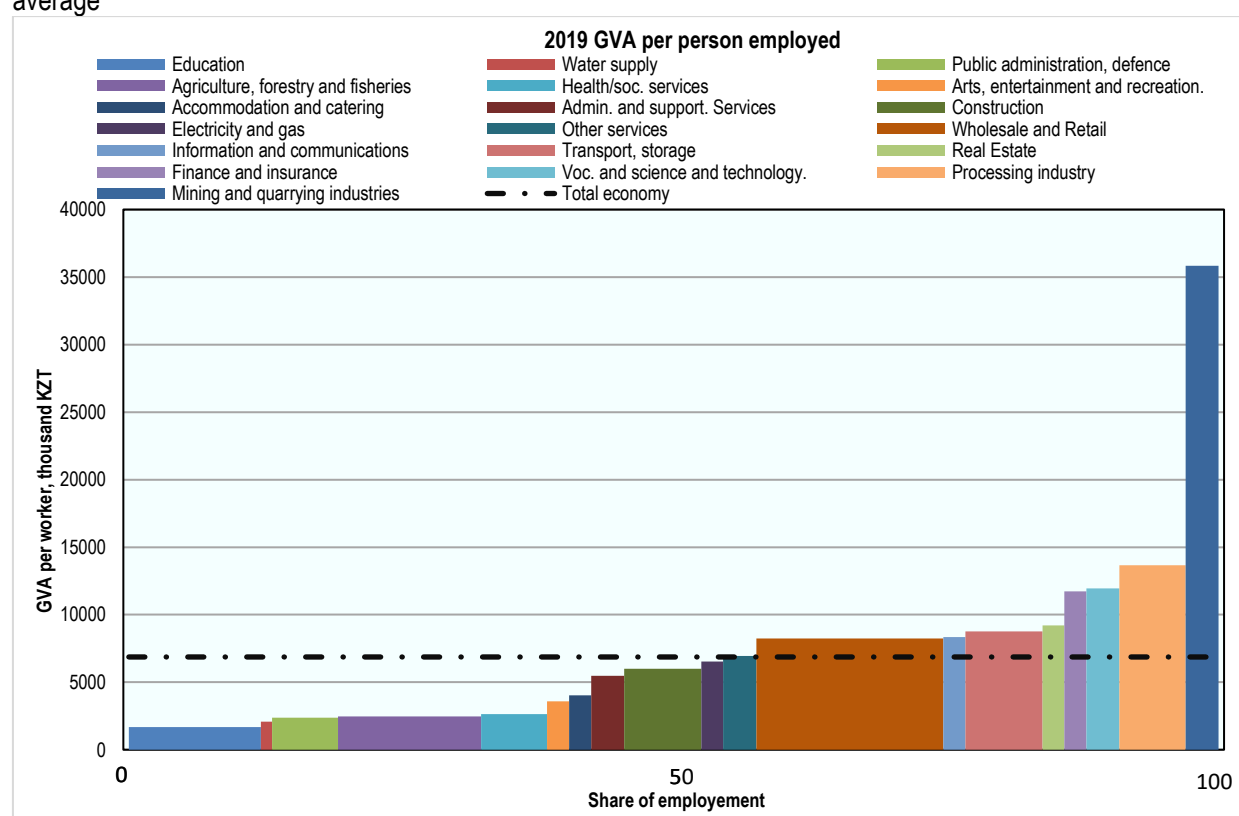
In this complicated context, it is increasingly important that the private sector is able to make a greater contribution to job creation and investment, and its persistent inability to do so is a reflection of the favoured treatment of extractive sectors, neglect of the business environment, low levels of competition, and the misallocation of public resources to large SOEs. The current crisis makes it more urgent than ever for governments across Central Asia to remove barriers to entrepreneurship and facilitate private sector development.

Kazakhstan is a telling example in this regard. Resource extraction accounts for over a fifth of GDP but employs only 2% of the population and yet accounts for the vast majority of productivity gains in the country (Figure 17(OECD, 2017_[88])). One can easily imagine that with suppressed demand for many key extractive goods, the contribution of these high-productivity sectors will fall in the years to come, redoubling the need

for policy-makers to intensify efforts to improve the investment attractiveness of other sectors, particularly non-extractive tradables.

Figure 17. Value added per worker (thousand KZT) and sectoral share of employment (2019)

High-productivity sectors account for a small share of total employment; most sectors are at or below the national average



Note: Horizontal axis runs 0-100%.

Source: (National Statistics Committee of Kazakhstan, 2020_[89])

More broadly, only 45.5% of Central Asian workers are employed in services, compared to 73% in OECD countries, but this division is not entirely illustrative of the region's employment situation and its vulnerabilities, since many of the region's service workers are active in sectors that have low levels of productivity and create little value added (ILO, 2020_[90]). The regional average also masks significant disparities at the country level, with the share of employment in services ranging from 64% in Kazakhstan to 33% in Tajikistan. At the same time, service-sector growth has in many cases been fuelled by inflows from resource exports; this is particularly true of high-value services like finance (ibid.) but also hospitality, retail trade and catering. There is therefore a sustainability issue at the heart of improving the diversity of employment opportunities, since policy-makers must endeavour that an expansion of non-tradable activities is not wholly reliant upon rent-producing sectors. Until such times as the economies of Central Asia achieve meaningful diversification, a number of service sectors will remain vulnerable to the drop in export revenues and deterioration in the external environment - though in the case of finance, the sector continues to account for a small percentage of regional employment and inward investment.

The crisis has hit labour migrants hard, particularly in Kyrgyzstan and Tajikistan

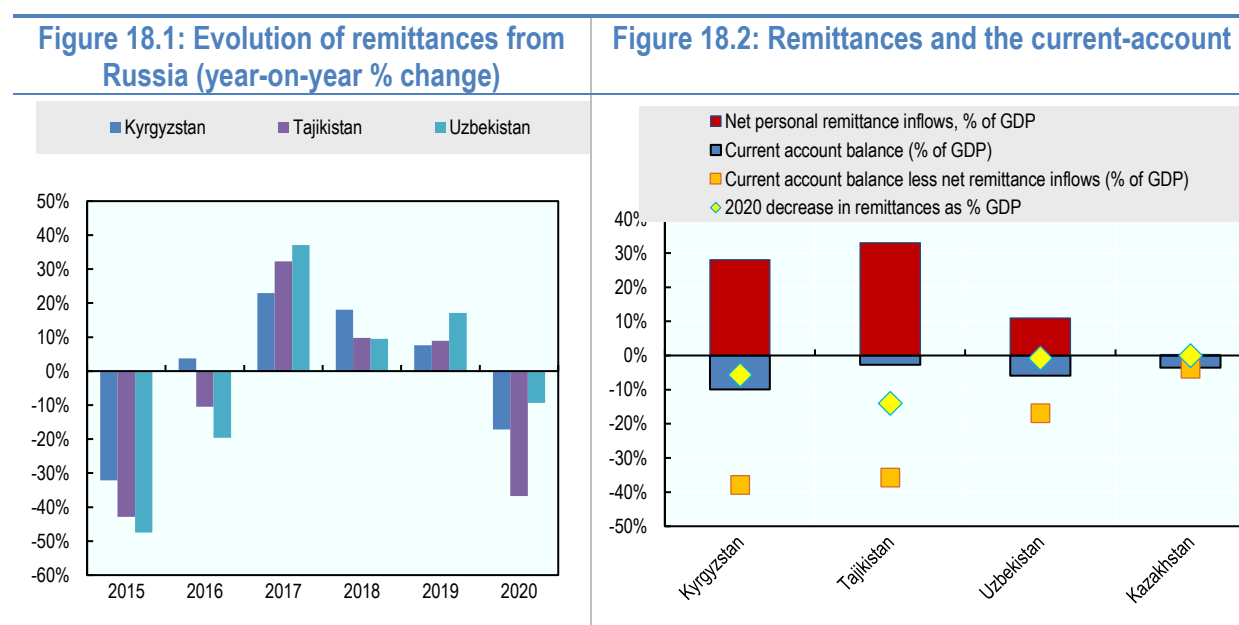
A lack of quality jobs across much of Central Asia continues to drive high levels of labour migration, particularly to Russia and Kazakhstan. Outward migration reduces the labour-market pressures generated by rapidly expanding labour forces in Central Asia, whilst migrant remittances create a significant source of revenue for both governments and households. In previous crises, the large number of labour migrants has served to some extent as an economic and social buffer, particularly for Kyrgyzstan and Tajikistan, which have the largest number of migrants (OECD, 2021^[91]).

The combination of demand- and supply-side barriers to labour migration caused by COVID-19 has overturned this historical pattern, at a cost to migrants, their families, and societies. The closure of borders and lockdowns stopped migrants traveling abroad for work, reduced the opportunities in the external markets where many already were, and suppressed job opportunities for those remaining in their country of origin. For labour migrants active in Russia, which hosts between 2.7 and 4.2 million Central Asian workers, the social and economic impact of mobility restrictions and lower demand was severe (OECD, 2021^[91]). One survey of Central Asian migrants in Russia found that 40% of respondents had lost their jobs and 75% were forced into unpaid leave, compared to 23% and 48% of the local population (Gurevich and Kolesnikov, 2020^[92]). Since the majority of remittances are used for immediate consumption needs, this further exacerbated the demand shock in Central Asia (Prokhorova, 2018^[93]).

Kyrgyzstan and Tajikistan were already the poorest countries in Central Asia, and as remittances are primarily used for immediate needs among households without savings, the reduction of labour migration has increased poverty. The poverty rate in Kyrgyzstan is estimated to have increased by 5.8 percentage points in 2020 and 47% of Tajiks are now living below the poverty line (OECD, 2021^[91]). The consequences of the loss of labour migration are particularly severe for youth, which make up a significant portion of migrants. Youth unemployment, which was already high before the pandemic (for instance, 21% in Tajikistan), has risen further, which could lead to additional instability in the region (OECD, 2021^[91]).

The largest relative quarterly decline in remittances received from Russia was seen in Kazakhstan in Q2 2020, but given the comparatively low importance of labour migration for the Kazakh economy, the impact of this decline was minimal. In Kyrgyzstan and Tajikistan, where labour migration is more important for the economy, remittances fell by 5.6% and 13.6% GDP, respectively. This had a profound effect on both domestic demand and external balances (Figure 18.2).

Figure 18. Labour remittances in Central Asia and the global pandemic



Source: (Central Bank of Russia, 2021^[94]) (World Bank, 2021^[2])

As with many issues linked to economic and social inclusivity, the impact of falling remittances is also likely to have a regional dimension. The geographic dispersion of migrant-dependent households across the region is uneven, which can lead to asymmetric, localised impacts. For example, in 2014, around 66% of labour migrants from Kyrgyzstan to Russia originated from the regions of Osh, Baktan and Zhalal Abad, regions accounting for 41% of the country's population (State Migration Service of Kyrgyzstan, 2014^[95]). Internal migration is also important in a number of Central Asian countries, particularly for seasonal agricultural work. In Tajikistan, for example, a little over 45 000 people migrated internally for economic reasons in 2018, yet Khatlon region alone accounted for almost half of these (State Committee on Statistics of Tajikistan, 2019^[96]). Most internal migrants come from rural settlements, indicating that any disruption to the movement of people not only has an impact at the national level but also disproportionately affects communities where job creation and public services are already limited (ibid).

Women may disproportionately bear the socio-economic costs of COVID-19

While men have experienced higher death rates across Central Asia (and elsewhere in the world), evidence points to women having borne larger socio-economic costs of the pandemic, including increased domestic violence, loss of employment, increased burdens of unpaid care work, and poorer job conditions (OECD, 2021^[97]). Some sectors with higher shares of female employment have been hit particularly hard by pandemic disruptions in supply chains, trade, and travel, including textiles, accommodation and food services, contributing family work in agriculture, and more generally part-time and informal employment (OECD, 2021^[91]). Childcare, which is typically provided by older family members, is not as available given the health risks to them. With school closures, women's already disproportionate domestic care burdens have increased; in Kyrgyzstan and Kazakhstan, 80% of women reported a rise in household tasks, compared with 58% of men. As a result, women have faced greater reductions in paid hours of work and more job losses, with 26% of women reporting a job loss in Kazakhstan, compared to 22% of men. Some

national surveys suggest that women-led businesses have been harder hit; in Kyrgyzstan, a higher proportion of women-led MSMEs (72%) reported they could not repay their loans, compared with those led by men (61%). Compounding the issue, women typically have less independent savings and access to bank accounts and have suffered income loss from reduced remittances (88% of women reported a decline compared to 47% of men) (OECD, 2021^[97]). All these factors risk a further widening of the gender pay gap in both the short- and long-term.

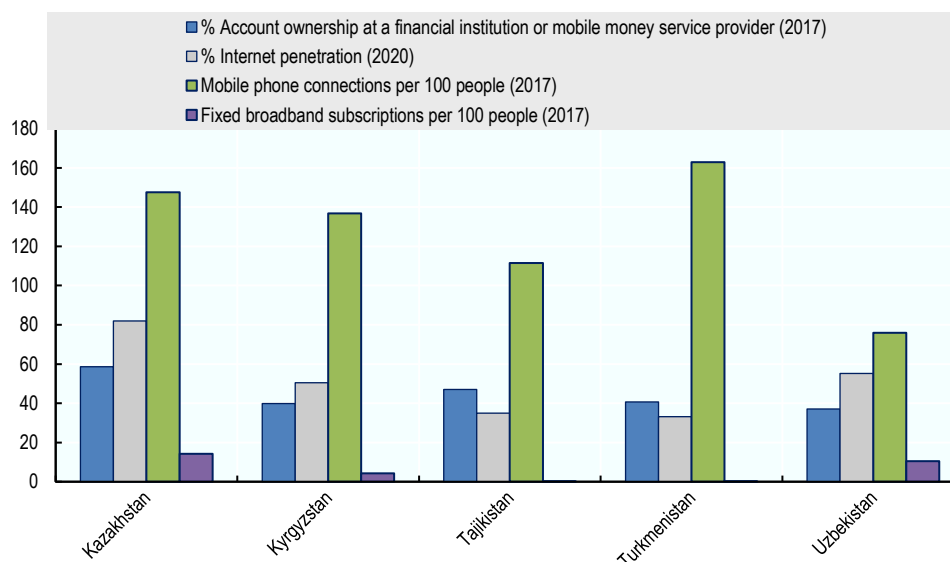
Administering support for those in need is complicated by high levels of economic informality

Central Asian economies are characterised by very high levels of informality: over 30% of economic activity in Kyrgyzstan, Kazakhstan, and Tajikistan is in the informal sector (OECD, 2021^[91]). In the context of the current crisis, this makes it harder for governments to administer support to those that need it most. Whilst a level of economic informality can act as a buffer against economic shocks, the nature of this particular crisis and the measures taken to contain it – namely restrictions on the movement of people – limit the informal sector’s traditional role as a source of resilience for many low-income people. Many informal firms, for example, lack the infrastructure that would allow them to move operations to a teleworking basis, or their work is of such a nature that it is impossible to do remotely. This not only makes it harder for them to adapt, but also puts workers at greater health risk if they do continue working in person – and all the more so given that informal workers tend to have poorer access to healthcare. The ILO estimated that the monthly earnings of informal workers fell by 60% during the first month of the pandemic (ILO, 2021^[98]). Only 38% of adults in Central Asia have any savings, so households struggle to withstand any drop in earnings (World Bank, 2019^[99]). Given the key role of many informal workers, from municipal functions such as refuse collectors to other essential services like *marshrutka* drivers, mechanics, or shuttle traders, interruptions to the informal economy could have severe implications for social and economic well-being.

However, the administrative barriers to supporting informal businesses and workers during the crisis are considerable. Formal-sector workers and firms often have access to safety nets or direct state support like that provided by both OECD and Central Asian countries in the wake of COVID-19. The same is not true for their informal counterparts. With many workers and firms off the government’s radar, it may be difficult for policy-makers to obtain accurate data on the real composition of their economies and work forces, complicating efforts to design policy responses and administer support to those that need it most. This is particularly true for direct financial support to workers and firms, as is currently being pursued in both OECD and non-OECD countries, with low financial inclusion and digital connectivity complicating such efforts in Central Asia (Figure 19). Governments in Central Asia have therefore had to find ways to ensure that measures to support households and firms extend beyond the formal sector, such as cash transfers in Kazakhstan and food support in Kyrgyzstan, which have had limited success (OECD, 2021^[91]).

Figure 19. Financial inclusion and digital connectivity in Central Asia

Financial inclusion is low but digital connectivity could provide options for innovative policy responses.

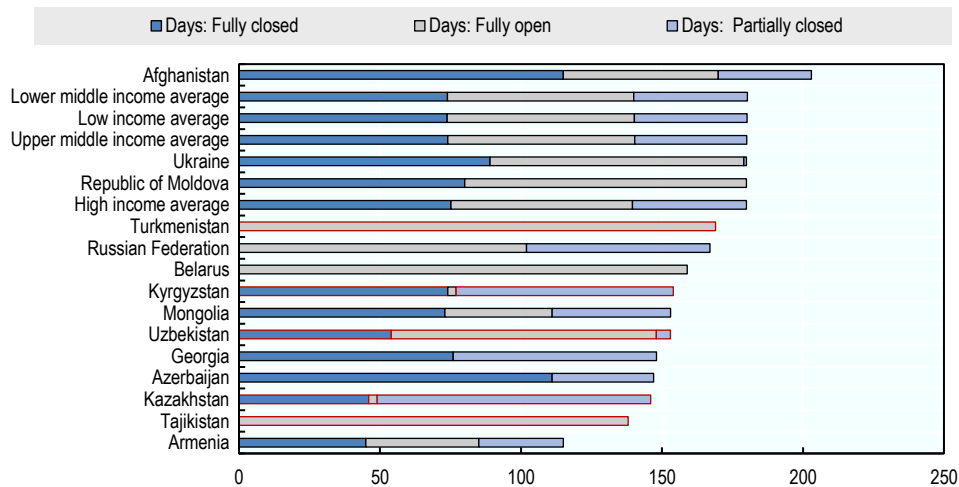


Source: (World Bank, 2017_[100]; Kemp, 2021_[101])

Disruptions to education risk further aggravating inequality in the region

The closure of schools around the world led to a dramatic decline in school days for children and risks having long-term consequences for educational outcomes, human capital development and inequality. In many places, teachers and students turned to distance learning to mitigate the interruption. All OECD countries provided learners with some type of online platform that contained educational resources for students, as well as training materials for teachers. However, many countries in Central Asia do not have the same capacity to implement digital solutions in education due to varying levels of technology access and internet penetration across the region. As a result, children in Central Asia not only attend fewer days of school than the average in a number of comparable income groups (Figure 20), but also the student and teacher population was comparatively ill-placed to pivot to distance learning due to limited access to digital infrastructure (just as workers would have had comparative difficulty in adopting many of the distance working arrangements practiced in OECD countries). For example, according to the PISA 2018 assessment, OECD countries report that more than 85% students have access to a computer at home. In contrast, the most recent survey data for Central Asia indicates a significantly lower level of access to home computers, with Kazakhstan leading (64.7%), followed by Kyrgyzstan (just 17.2%) and Tajikistan (9.2%) (World Economic Forum/INSEAD, 2016_[102]). No data for Turkmenistan or Uzbekistan are available. The question of internet penetration further complicates the ability of policy-makers in Central Asia to pivot to distance learning and working arrangements – whilst mobile internet penetration is relatively high, the number of households with access to the internet at home remains variable and generally low throughout the region (Figure 19) (World Economic Forum/INSEAD, 2016_[102]) (Kemp, 2021_[101]). It is therefore essential that governments in Central Asia ensure that policy responses to disruptions in their education systems are inclusive and take local constraints into account.

Figure 20. School closures in the Eurasia region during the pandemic



Source: (UNICEF, 2021^[103])

Despite numerous ongoing projects to improve digital connectivity, internet access remains a significant barrier to home learning in Central Asia. In 2019, fixed internet penetration in the region was 54%, with significant variation across countries. Quality of access is equally variable. International bandwidth per capita in Turkmenistan, Tajikistan, and Uzbekistan ranges from 1.8 to 12 Kbps, with less than 10 Kbps per capita considered unusable. Even in Kazakhstan, which has the best internet in the region, the testing phase to launch online classes showed that internet bandwidth in the country was not sufficient to support online learning for 2.5 million children. Poorer and more rural residents, who have generally lower access to internet connectivity, are at particular risk of being disproportionately affected by shifts to distance learning and working (OECD, 2020^[1]).

At the same time, Central Asia has comparatively high rates of mobile penetration, which might provide an avenue for delivering digitalised services to households and businesses as countries attempt to contain the crisis (Figure 19). Although many countries have relatively uncompetitive telecommunications markets, the monthly price for 1 gigabyte of mobile internet is below the 2% monthly GNI per capita target in all Central Asian countries except Tajikistan and Turkmenistan, where it is 2.9% and 3.6% respectively (Cable.co.uk, 2021^[104]; World Bank, 2020^[4]). Partly because of this, Tajikistan has stated that the country will not implement distance learning, and the government opted to maintain in-person teaching throughout the crisis, as did Turkmenistan. In light of connectivity challenges, many countries in the region implemented educational broadcasting on national television, while countries with better internet access, such as Kyrgyzstan and Uzbekistan, have established digital learning platforms.

2. Policy challenges for recovery

Introduction

This chapter considers four areas that governments in Central Asia must address if they are to succeed in “building back better” from the shock of the global pandemic: improving public finance and revenue management, improving framework conditions for private sector development, implementing a meaningful and effective digital agenda, and laying the foundations for a green recovery. If properly embedded in the recovery agenda, reforms in these four domains could help set the region on a trajectory that is more sustainable, more inclusive, and more resilient to the types of shocks that have buffeted Central Asia since 2008. In many ways, success in any one of these areas depends on progress in the others. For example, a transformative digital agenda and significant investment required to upgrade and expand the region’s infrastructure will not be possible without better management of public finances, improved conditions for private sector development, and a more attractive environment for FDI.

Public revenue management

COVID-19 has had a severe impact on government revenues across the globe. This global trend has been compounded by Central Asian governments’ structurally higher reliance on revenues from trade, remittances, commodities, and natural resources. As growth slowed or turned negative, and in keeping with the fiscal relaxation that was seen across Central Asia, tax revenues fell faster than GDP in 2020, while persistently low oil and volatile commodity prices have added to the crisis’s impact on the finances of Central Asian economies (OECD, 2020^[1]).

The economies of Central Asia remain highly vulnerable to a tightening of global financial conditions, especially if US interest rates rise quickly. As demonstrated through the early stages of the COVID-19 pandemic, economies in the region are primarily affected by large portfolio outflows (portfolio flows to Central Asia have historically been almost twice as sensitive to changes in global uncertainty), a strong decline in equity markets, and a rise in global risk sentiment which brings 10-year government bond yields and sovereign spreads up (IMF, 2020^[105]; IMF, 2021^[44]). While equity markets are not yet of great importance to the region’s private sector, they nevertheless play a role for many of the energy firms active in Central Asia. A new tightening might prove a crucial challenge to the region’s sustainability prospects given the levels of external sovereign exposure. Tajikistan and Uzbekistan, for instance, have almost all of their debt denominated in USD (respectively 100% and 97%), leaving them vulnerable to currency depreciation. Kazakhstan appears somewhat shielded, as only 35% of the country’s debt is held in USD and EUR, but the economy remains highly dependent on capital inflows to the energy sector (European Securities and Markets Authority, 2020^[106]; OECD, 2021^[107]). If portfolio outflows were to restart, the region could suffer a major blow to investment, placing additional pressure on the balance of payments, causing disorderly exchange rate adjustments, and dimming prospects for recovery.

Fiscal policy should continue to support the economy, while tax policy and administration should be reformed to improve financial resilience and stability

There is a need to manage the withdrawal of state support for key economic sectors so as to avoid confronting firms with an unnecessary cliff edge; a gradual tightening of access to support should proceed in lockstep with the economy's recovery. While the sustainability of public finances and debt will be a key challenge for policy-makers in the coming years, the withdrawal of public support to protect viable firms and households needs to be gradual (IMF, 2021^[44]; OECD, 2021^[108]). In advanced economies such as those of the OECD, the withdrawal of fiscal stimulus may be made easier by the effective transmission monetary policy to the firm level – something that is less true of the economies of Central Asia, where under-developed financial sectors mute the impact of monetary policy instruments on the real economy. The aftermath of the 2008 Global Financial Crisis highlighted the dangers of a premature withdrawal of stimulus, but policy-makers in Central Asia should nevertheless be cognisant of the risk of resource misallocation if public support is not sufficiently rationalised and monitored. Even as the public health crisis abates, the region's economy remains in a critically uncertain state – one where perfectly viable firms may go bankrupt, and where laid off workers may struggle to find employment (Blanchard, Philippon and Pisani-Ferry, 2020^[109]). It is also worth noting that the net fiscal cost of continuing with certain subsidies is likely to be substantially lower than prematurely withdrawing them, since the state would avoid a situation where a larger number people are unemployed in an economy with little job creation (Ibid.). Proceeding gradually can help mitigate an unnecessary loss of productive firms and workers, and contribute to building a more inclusive economy in the aftermath of the crisis.

Premature removal of support policies could trigger a negative chain reaction of bankruptcies, defaults, and a surge in unemployment (OECD, 2021^[108]; IMF, 2021^[44]). In Kazakhstan, which financed its deficit mainly through domestic borrowing, such a negative scenario could trigger a crisis in which domestic banks would be weakened on both sides, liquidity (loss of confidence) and solvency (rise in non-performing loans), as businesses fail. In such a scenario, the government would face calls to recapitalise the banks, further weakening market confidence in its ability to service its debt. This would in turn lead to a rise in interest rates, and tightening of lending conditions, etc. Central Asian economies seem to be taking steps to avoid this scenario, combining continued but more targeted short-term support with plans for fiscal consolidation and debt stabilisation in the medium-term. Tajikistan included a target of 2.6% of GDP fiscal deficit for 2021 in its state budget and plans to use concessional external borrowing to close the financing gap. Uzbekistan plans to finance its deficit through increased public borrowing before stabilising its debt at 45% of GDP over the medium term, while Kyrgyzstan is targeting a fiscal deficit of 3% of GDP over the same horizon (World Bank, 2021^[110]).

Targeted fiscal policy can also help the region accelerate the green transition. As discussed in the Green Transition section of this chapter (page 51), fiscal policies can play a significant role in facilitating the transition to a greener and more sustainable economy in Central Asia. The current crisis, with fiscal pressures that will invariably linger in the recovery period, provides an opportunity to reverse a number of long standing fiscal disincentives for diversification and decarbonisation. To varying extents, each government in Central Asia continues to maintain wasteful fossil fuel and energy subsidies, whilst having tax regimes that fail to create incentives for more sustainable practices in the extractive sectors. At the same time, underdeveloped carbon pricing mechanisms and long-standing issues with practices such as flaring penalties contribute to a sense that a number of governments in Central Asia continue to see their hydrocarbon and extractive sectors as sources of rent maximisation. Most of these practices, in some way, are maintained or made possible through fiscal policies, often in ways that contradict governments' Paris Agreement commitments. While the recovery from the global pandemic might not appear as the most propitious moment to undertake fiscal reforms that risk diminishing the tax base in the short term, doing so

now could help set a direction of recovery and development that is more sustainable and inclusive in the longer term.

A comprehensive reform of resource mobilisation, focusing on tax policy, could support recovery and reforms in the coming years. Tackling inefficient tax expenditures, broadening tax bases and tapping new tax bases such that the tax mix is less detrimental to growth should be priorities of ongoing tax reforms across Central Asia. For instance, taxes on property, natural resource rents, consumption, and environmental taxes rely upon tax bases that are less mobile, hence ensuring a stable tax base, and are less distortive and more beneficial for growth compared to taxes on personal or corporate income. Increasing the share of these taxes in the tax mix could therefore allow lower taxes on employment and human capital investment, supporting growth without reducing tax income. Increasing the base for VAT could also be considered. However, measures to broaden the tax base and increase reliance on direct taxation need to be carefully designed to ensure that the reforms do not exacerbate inequality, focusing on the progressive effects of the measures (OECD, 2018_[111]). This implies, *inter alia*, looking not only at all taxes together but also at patterns of public expenditure, especially on unemployment, disability and other benefits. As a large body of OECD work demonstrates, interactions between tax and benefit system can create unexpected and often perverse incentives for households, as well as affect inequality. The focus should be not on the progressivity or regressivity of any given tax, but on the effects of the fiscal system as a whole on inequality and incentives.⁴

Despite recent efforts to create new centres for global finance within Central Asia, a view in certain academic and policy quarters has persisted on the region being detached from the global financial system (Heathershaw and Cooley, 2015_[112]). Yet, in certain ways the development of the Astana International Financial Centre in Kazakhstan, and recent discussions around the creation of a similar institution in Uzbekistan, have simply formalised what for many years has been the reality: that the economies of Central Asia are deeply intertwined with global finance.

With this come the risks of base erosion and profit shifting (BEPS) faced by many OECD countries. A quick glance at the Phantom FDI database – which tracks FDI flows considered to be “round tripping”, that is, where revenues are routed through an offshore low tax jurisdiction before returning to the sending country – is indicative, with all five countries featuring prominently (Damgaard, Elkjaer and Johannesen, 2019_[113]). Central Asian economies remain susceptible to capital flight, and are particularly vulnerable to its effects, since it diminishes already low tax revenues and creates additional burdens for tax administration. In addition, such practices can distort the playing field between large incumbent firms and SMEs, thereby reducing business dynamism (OECD, 2018_[111]). Effective measures to address BEPS and ensure the integrity of the tax system should be therefore an inherent part of the reform effort across Central Asia to improve the business environment (OECD, 2021_[107]).

Key challenges ahead

Governments should seek to strengthen capital markets and banking sector resilience

The development of stronger capital markets is vital to private sector development across Central Asia. Financial systems across the region were quite stable in the pre-pandemic era (IMF, 2020_[105]). Nevertheless, the 2008 and 2014-15 crises undermined the resilience of banking sectors that were in any case under-developed. The absence of deep capital markets and well-developed banking systems has

⁴ For more on the OECD Tax-Benefit Model, see <https://www.oecd.org/social/benefits-and-wages/>.

constituted a drag on private sector development. The situation has been particularly acute in Kazakhstan, where the liquidity of the tenge has remained challenging, reflecting the high level of dollarisation and tight monetary policy of the National Bank, as well as the significant underdevelopment of local money markets (Preimanis and Shanshiashvili, 2017^[114]).

The regional and national effects of COVID-19 are likely to exacerbate existing vulnerabilities and create new ones related to liquidity provision and prudential regulation. Kazakhstan and Kyrgyzstan allowed an acceleration of consumer credit growth in 2020 by relaxing lending standards, including subsidised and directed lending. The need for liquidity provision to households and businesses during lockdown led to a further easing of prudential regulations in almost all countries in the region (OECD, 2020^[11]). The combination of both trends might drastically increase capital needs of banks, especially in Kazakhstan, where four of the 14 largest banks already had such needs in 2020 (IMF, 2020^[105]). In addition, non-performing loans (NPLs) are likely to increase across the region following the pandemic, and this will further constrain banks' liquidity. All this could prevent desperately needed credit supply during the recovery. The issue might be most pressing for Kyrgyzstan and Tajikistan, which were already engaged in a resolution and restructuring agenda prior to the pandemic. Despite Uzbekistan's NPLs tripling to 4.5% in November 2020, the country's financial system seems so far sufficiently well capitalised to absorb potential credit shocks. By contrast, while in Kazakhstan NPLs remain little changed so far, they might increase in the foreseeable future once support measures are wound down (IMF, 2021^[44]).

Prudent public debt management will be essential to sufficiently resource reforms and private sector financing necessary for economic recovery

Debt ratios across the region increased drastically with the pandemic. While levels of indebtedness in Central Asia were seen as generally sustainable prior to the crisis, public debt is expected to increase in the medium-term, constraining fiscal space and increasing the risk of debt distress for some countries. Tajikistan, and Kyrgyzstan in particular, face high debt distress risks and in 2020 benefitted from the G20 "debt service suspension initiative (DSSI)" (OECD, 2020^[64]; Club de Paris, 2020^[115]; Club de Paris, 2020^[116]). In addition, Tajikistan and Kyrgyzstan asked for debt forgiveness from China, their largest single creditor (van der Key, 2020^[58]; China-Africa Research Initiative, 2021^[63]).

At present, governments' reliance on public banks risks crowding out private sector finance. Across the region, the crisis has increased governments' reliance on financing from their public banks. This might lead to a further crowding out of credit to the private sector, the more so if recovery prospects fall short of government targets. On average, banks across Central Asia have lower liquidity ratios and higher rates of government lending than banks in most OECD and upper-middle-income countries. In cases of financial stress, lending to the private sector may be drastically reduced as lending to governments increases, since the sovereign is perceived to be the lower-risk borrower. This can reinforce the negative impact of the crisis on the private sector through a liquidity and credit contraction. Governments and Central Banks will need to shield their banking sectors to avoid an unsustainable build-up of liquidity pressures that could lead to a credit crunch. For instance, some of the region's central banks are already considering forbearance for households and SMEs. Should the financial situation of banks deteriorate, the government could encourage them to recognise upfront losses and grant them additional time to rebuild their capital positions (IMF, 2021^[44]).

Improved tax policy and administration could contribute to greater financial resilience

Reformed tax policy and improved administration could widen the tax base across Central Asia's economies and give contribute to greater financial resilience. Despite a number of recent reforms, taxation remains a challenge in each of the five countries. While the consequences are similar throughout Central Asia, the legal and policy responses required are specific to the country's circumstances and tax systems. In Kyrgyzstan, for example, the prevalence of individual entrepreneurs, who are subject to a more beneficial tax rate than SMEs, contributes to a high level of economic informality. The current tax policy may create disincentives for firm growth. Across the region, VAT policy may inadvertently create disincentives for firm formalisation. Meanwhile, large firms – including international investors – regularly complain of complex and changeable tax administration (OECD, 2021^[107]).

Governments can do more to reduce the erosion of their domestic tax bases. As in many other countries, domestic tax BEPS continues to weaken the financial stability and the resilience of public revenues in Central Asia. As the region's economies pursue greater levels of FDI to support their economic development, governments could consider adhering to the OECD/G20 Inclusive Framework on BEPS⁵. At present, only Kazakhstan is a member of the initiative, so there is significant scope for the region to improve inter- and intra-regional co-operation on issues around tax avoidance, the coherence of international tax rules, improving transparency, and addressing the challenges that can arise from digitalisation.

Addressing legal and policy barriers to private sector recovery and development

The challenges that governments in Central Asia face during the pandemic serve as a stark reminder of the importance of reforms to the legal and policy environment for private sector development. The region's heavy reliance on exports of primary commodities and cheap labour largely reflects the relative weakness of Central Asia's private sector and its inability to assume a larger role in generating jobs and growth.

Improving the framework conditions for private sector development will be crucial for the region's long-term recovery. The success of such reforms will have significance for a range of government priorities, including the implementation of ambitious digitalisation agendas, the creation of new transit corridors for trade, the construction of new and sustainable infrastructures, and the realisation of decarbonisation commitments, as well as for efforts to foster innovation and job creation.

Progress in developing the legal and policy framework for business in Central Asia

Central Asian governments have adopted fairly robust legal frameworks for business and investment activities with limited statutory restrictions on investment. Each country has an extensive body of business legislation, covering issues like intellectual property, licensing, permits, and firm creation. In recent years, governments have undertaken reforms to streamline aspects of their legislative frameworks, making firm creation easier and lowering licensing/permitting costs and requirements, while creating one-stop shops for government-to-business services. Significant progress has been made in opening up the region's statutory openness to foreign investment; Central Asia's economies are now close

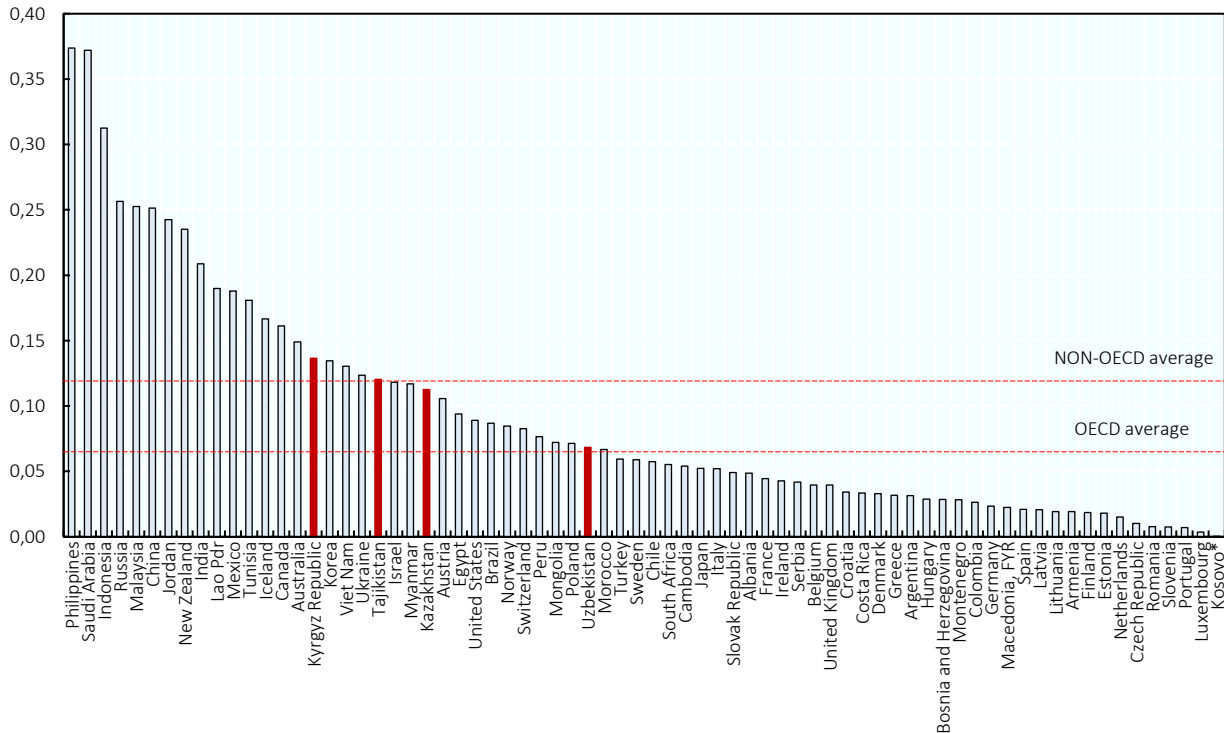
⁵ See

<https://www.oecd.org/tax/beps/about/#:~:text=The%20OECD%2FG20%20Inclusive%20Framework,needed%20to%20tackle%20tax%20avoidance.>

to the non-OECD average on the OECD FDI Regulatory Restrictiveness Index, which measures statutory openness to investment (Figure 21). On paper, the region's economies are open for business.

Figure 21. OECD FDI Regulatory Restrictiveness Index (2020)

Central Asia's economies perform close to the OECD average in the OECD FDI Regulatory Restrictiveness Index.



Note: Turkmenistan is not included in the index. Values range between 0 for open and 1 for closed.

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence. Hereafter referred to as Kosovo.

Source: (OECD, 2019_[17])

Central Asian countries have also established new institutions to support business and investment activities. Most governments in the region have created business ombudsmen to support dispute resolution, and most have made significant progress in developing and promoting the use of alternative dispute resolution and international arbitration as well. At the same time, recognising the need to improve policy coherence and to ensure that policies correspond to real business needs, they have enshrined public private dialogue (PPD) platforms in law, while foreign investor councils and business intermediary organisations (BIOs) have grown to represent the views and concerns of firms in numerous sectors.

Nevertheless, serious structural issues remain. Despite these improvements, the countries of Central Asia still lack certain fundamental pillars of a market economy, including open competition and good governance. Implementation failures and weak state capacities mean that *de jure* reforms undertaken often fail to change the *de facto* experience of economic actors on the ground (OECD, 2021_[107]). State

intervention in economic activity remains extensive, limiting firm entry and development, especially in regulated sectors. Left unaddressed, these issues undermine otherwise promising reform efforts.

Key challenges ahead

Governments should redouble efforts to strengthen competition and competitive neutrality

Weak competition limits diversification and the attraction of new investment. Meaningful diversification will require the emergence of new firms and sectors, as well as new activities within sectors. Their emergence and development cannot be dictated in a top-down fashion; the role of entrepreneurship and open markets is crucial. Highly regulated product markets and anti-competitive behaviour from incumbents, particularly SOEs, makes it harder for new players to enter and compete, and reduces incentives to innovate and invest. Also important are policies that facilitate exit, since the maintenance of poor performers ties up resources in less productive uses and prevents efficient reallocation.

The role of SOEs in Central Asia's economies creates particular challenges for bridging the gap between the *de jure* and *de facto* business environment. Poor SOE governance not only reduces their competitiveness and efficiency, it also distorts the competitive playing field for other firms. Large and unproductive SOEs, often enjoying many regulatory concessions, can – and frequently do – exploit dominant market positions, raising prices and discouraging firms from investing in new activities and better products. Many sectors remain entirely state-controlled and vertically integrated, whilst opacity with respect to the definition of SOEs in each country hampers assessment of their scope and effectiveness, as well as possible improvements. At the same time, forms of corporate structure that were intended to be temporary arrangements, such as unitary enterprises, have remained and even proliferated in recent years.

The application of the OECD economy-wide Product Market Regulations (PMR) indicators⁶, which measure the regulatory barriers to firm entry and competition in a broad range of key policy areas, to the economies of Central Asia could give policy-makers a clearer view of competition-related barriers in their economies. The PMR indicators provide a deep assessment, based on around 1500 highly specific horizontal and sectoral policy settings spanning the whole range of economic and regulatory policies. As a result, they constitute a sound basis for developing regulatory reform roadmaps and, in particular, for identifying “low hanging fruit”-reforms with significant impact that could be executed easily and at low cost.

Better dispute resolution mechanisms will be key to increasing FDI attractiveness and private sector development

The reliability of dispute resolution mechanisms must improve if Central Asia is to attract new investment and foster domestic firm creation. Complex and unpredictable regulatory requirements, compounded by weak adjudication and enforcement may not only deter firm and investment growth, but also lock the nascent private sector into informality as businesses seek to minimise interaction with public agencies. Improvements in the legal and institutional environment that are not accompanied by improved adjudication and increased enforcement capacity may also enable businesses to avoid perfectly legitimate regulations and taxes. The modernisation of judicial systems has improved the procedural efficiency of courts, but businesses continue to express concerns over judicial independence and the enforcement of court decisions, while the use of alternative dispute resolution (ADR) mechanisms remains limited (OECD, 2021_[107]). The development of forms of ADR like mediation, which are significantly more cost effective for

⁶ See <https://www.oecd.org/economy/reform/indicators-of-product-market-regulation/>.

firms and more likely to prevent investor-state relations from deteriorating irreparably, could make a significant improvement in the dispute resolution landscape across Central Asia.

Governments must be clear about the goals of privatisation campaigns, and ensure that methods reflect a solid understanding of those goals

Most countries in Central Asia are currently undergoing some kind of privatisation campaign, and these privatisations will likely continue during the recovery period following the pandemic. In many cases, privatisations are justifiable and economically rational, particularly where the privatised firm is subject to real competition and market discipline. State ownership of productive enterprises can create conflicts of interest – particularly where the state plays both the role of regulator and regulated party – as well as perpetuating rent-seeking behaviour from insiders, which limits the ability of such firms to play a productive role in the national economy.

At the same time, any steps towards privatisation must be well thought out, and governments should be aware of the limitations and practical realities of disposing of public assets. This is particularly true for small, illiquid public holdings that do not – and likely will not – generate much revenue when privatised, especially given concerns about corporate governance and minority shareholders' rights. Such stakes may still be worth selling off, since the management of assets the state has no interest in keeping can be costly. Governments may therefore want to consider streamlined procedures for the disposal of small, illiquid holdings. At the same time, improved corporate governance frameworks can, if implemented consistently and effectively, enhance the appeal of such stakes to investors.

Privatisation in sectors where there is limited competition – particularly in non-tradable sectors – is unlikely to bring economic benefits. This is especially important in some non-tradable sectors, such as power and utilities, since the competitiveness of tradable producers depends in no small measure on the efficiency of the non-tradable services on which they rely. In many cases, there may be a need for pre-privatisation restructuring – such as the unbundling of vertically integrated SOEs currently being undertaken in Uzbekistan – to ensure that public monopolies do not simply transfer into private ownership, and to allow for the unbundling of certain activities that may need to remain regulated public monopolies. Corporate restructuring is also important here, since the existing corporate structure of an SOE may not be suitable for market conditions – similar caution must be paid to transitory forms of corporate structure, such as state unitary enterprises, which risk perpetuating inefficient and wasteful business practices to the detriment of public finances and the business climate. And, of course, it is critical to create a system of tenders, auctions, etc, in which all participants have, at least in principle, an equal chance of acquiring the assets, and to ensure transparency and equity in the actual conduct of sales. Across the region, the practice of structuring privatisation requirements so as to favour specific bidders remains all too prevalent.

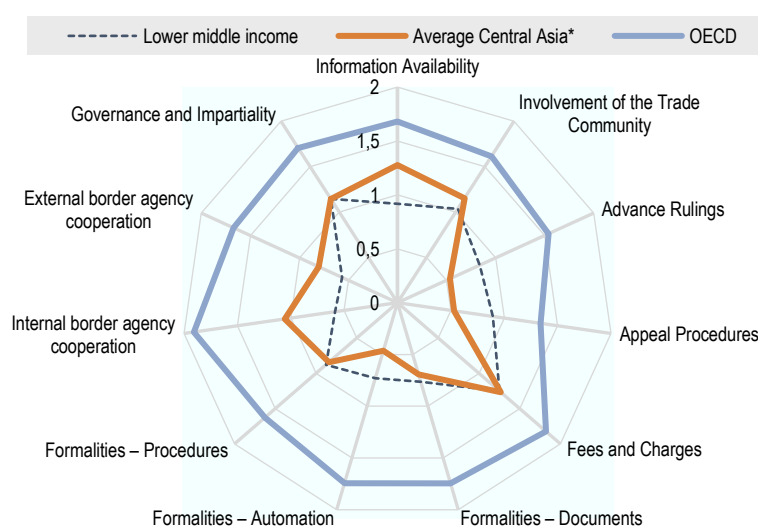
Greater regulatory alignment and intra-regional co-operation would help improve economic integration while boosting Central Asia's attractiveness for FDI

Greater regulatory alignment and trade facilitation reforms are necessary if the region's export-oriented firms are to realise their full potential. Restored trade and greater inclusion in global value chains will strengthen the private sector and improve social, business, and sanitary conditions. As noted above, Central Asian countries rely heavily on foreign trade and yet also face specific barriers to international trade integration. Policy-makers can still do much to lower these barriers, supporting domestic exporters, improving and aligning regulatory standards, and improving regional co-operation could help lower trade costs and foster connectivity. The OECD Trade Facilitation Indicators, which measure the economic 'thickness' of borders – the impact of policy and administration on trade costs, as opposed to

geographical and infrastructure factors – give an instructive snapshot of some of the challenges for firms engaged in trade in Central Asia. While Central Asia performs better overall than the lower middle-income average in a number of areas, the region nevertheless significantly lags the OECD average (Figure 22). That many of the weakest areas – for example, external border co-operation, automated processes, and advance rulings – are tied to issues of cross-border co-operation is indicative of the need for policy-makers in Central Asia to coordinate with their neighbours in order to improve trade facilitation.

Figure 22. Central Asia and the OECD Trade Facilitation Indicators

Cumbersome border procedures and a lack of regulatory alignment act as a significant ‘soft infrastructure’ penalty for the region’s investment attractiveness and export-orientated firms



Note: TFIs take values from 0 to 2, where 2 designates the best performance that can be achieved. Average scores of Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. Turkmenistan is not included in the indicators.

Source: (OECD, 2019_[118])

Digital Transformation

In Central Asia, as in OECD countries, the COVID-19 pandemic had a profound impact on how businesses and governments operate. Limitations on in-person activities provided a new impetus for the digitalisation of governments and economies, which was already underway across the region (OECD, 2020_[119]). Central Asian governments recognise the importance of mainstreaming digitalisation into the region’s reform programmes. Since 2018, all five Central Asian states have adopted comprehensive national strategies for digitalisation that recognise the benefits of digitalisation and the ways it could support other long-term development priorities.

However, unresolved issues in Central Asia with respect to both infrastructure and the regulatory framework risk limiting the effectiveness of policy-makers’ efforts. In addition, the highly variable absorptive capacities for ICT solutions of the region’s firms, workers, and public sector agencies create demand-side barriers to digital uptake. This will reduce the effectiveness and inclusivity of government digitalisation agendas.

Progress on digitalisation in Central Asia

All governments in Central Asia have adopted whole-of-government digitalisation strategies, and policy-makers see the digital transformation as integral to long-term economic development.

Whole-of-government approaches support inter-operability and data protection. They also enable policy-makers to better prioritise interventions, which is of particular importance in a constrained fiscal environment. Since March 2020, Kazakhstan has adopted ten new or revised laws on data exchange and protection and eleven on inter-agency co-ordination. While Kyrgyzstan's *Tunduk* is widely known as a one-stop shop for provision of e-services, it is, at its core, a secure inter-agency data exchange and identification system based on Estonia's world-class X-Road (Tunduk Electronic Interoperability Center, 2019_[120]). In the past year, Turkmenistan similarly laid groundwork for future e-government development through laws on inter-agency data exchange and digital identification (State Information Agency of Turkmenistan, 2020_[121]; 2021_[122]). These efforts are an encouraging indication of government readiness not only to improve the regulatory and legal framework necessary for successful digital service delivery, but also to address back-office impediments to their implementation.

Governments in Central Asia have begun to increase the number of digitally delivered services, and a number have created one-stop shops to support firms and entrepreneurs.

Throughout the pandemic, governments have built upon digital foundations that were laid in the preceding years. Kyrgyzstan and Uzbekistan, for example, made use of new and existing OSS to broaden the range of available e-services (Blyum, 2020_[123]; Sulaimanova, 2020_[124]; OECD, 2020_[1]). This enabled policy-makers to mitigate the duplication of initiatives that has often characterised digitalisation in the region. The period of disruption also saw the introduction of new initiatives, such as a new online and partially automated justice system ("e-sud") in Uzbekistan and digital accounting services in Kyrgyzstan (Badalov, 2020_[125]; Uzbekistan State Information Agency, 2020_[126]; Kabar, 2020_[127]). The pandemic itself also spurred some new e-services, such as a digital vaccination passport in Kazakhstan and online volunteer registries in Kyrgyzstan (Tulesheva, 2021_[128]; Kabar, 2021_[129]). In each of these cases, developments and improvements were possible due to regulatory advancements made prior to the pandemic.

While access to internet services and ICT solutions has improved across Central Asia, significant progress is still needed for government policy to have a transformative and equitable impact on the public and private sectors.

The percent of Central Asians currently using the internet is below the global average (60%) for every country except Kazakhstan (80%) (Kemp, 2021_[101]). In Turkmenistan and Tajikistan, about a third of the population uses the internet, and in Kyrgyzstan and Uzbekistan, half do. Every OECD country targets *minimum* 30 Mbps mobile internet speed for 100% of households, and the OECD average was just under 80 Mbps as of 2019; Kazakhstan and Kyrgyzstan have the fastest average mobile speeds in the region, at about 20 Mbps as of 2021. Tajikistan has a 15 Mbps average speed, and Kyrgyzstan has 13 (no data for Turkmenistan) (OECD, 2021_[130]; Kemp, 2021_[101]). An OECD survey found that 59% of business associations in Central Asia had members that struggled with digital infrastructure when adapting to the pandemic. These problems are worse in rural areas and among underprivileged groups, exacerbating existing inequalities. However, Central Asian governments continue to make strides to improve the situation, and growth in internet penetration over the last five years has been faster than the global average in Kyrgyzstan, Tajikistan, and Turkmenistan. The Kazakh, Uzbek, and Kyrgyz governments are working to expand digital access, including in rural areas, through new and ongoing programmes and public investments, most notably USD 2.5bn in new spending in Uzbekistan, which was announced in early 2021 (Kabar, 2020_[131]; The Tashkent Times, 2021_[132]; Lancaster, 2020_[133]).

Key challenges ahead

Governments must provide clear roadmaps for the digital transformation

Strategies need to be accompanied by implementation roadmaps, including a clear delineation of responsibilities. While whole-of-government strategy documents are an important starting point, governments must ensure that they have clear implementation roadmaps (already largely the case in Kazakhstan and Kyrgyzstan) and act quickly to identify regulatory or technical barriers. Digitalisation programmes have the potential to fundamentally change *how* governments and business work through the introduction of new processes rather than just digitised analogue ones. Therefore, governments should also use digital tools to collect data and feedback from users, which will allow continuous improvement.

Policy-makers should ensure that digital service delivery reflects existent short-term infrastructure issues and absorptive capacity. To reach populations without fixed internet access and avoid exacerbating existing inequalities, it will be necessary to pursue long-term goals, like education and infrastructure development, in tandem with short-term fixes, like specialised skills training and mobile-optimised services. For instance, during the pandemic Mongolia launched its X-Road-based OSS with a fully mobile version to account for better mobile than fixed infrastructure (which is also true for post-Soviet Central Asia). This resulted in use by 35% of the population within the first five months (Bedoui, 2021^[134]). To reach rural and underserved populations with such digital services and training, proactive awareness campaigns will also be necessary.

A co-ordinated, regional approach to digitalisation could have significant benefits for intra-regional integration and infrastructure development. The internet availability and speed of landlocked countries, like those of Central Asia, depend on the ease and cost of connecting to the ocean through neighbours, because 99% of global internet data travels by ocean cables (WEF, 2016^[135]). Collaborating on infrastructure projects, such as cross-border fibre routes, and sharing experiences and best practices with neighbours is therefore likely to be highly productive (UN ESCAP, 2017^[136]). International and donor-funded projects could be valuable forums for this. These include the ICT initiatives being put forward under China's Belt and Road Initiative, and the World Bank's regional programme Digital CASA, which is already in Kyrgyzstan (but has not yet disbursed most of its funds) and soon to be in Uzbekistan and Tajikistan (World Bank, 2021^[137]; World Bank, 2021^[138]; World Bank, 2021^[139]; UN ESCAP, 2017^[136]).

Policy-makers must reduce barriers to private investment in digital transformation

Greater levels of private investment in the region's digital development are needed. Large international projects, such as the World Bank Digital CASA initiative, can make significant improvements to the region's digital infrastructure, especially in the backbone services necessary to ensure equal access across regions. However, funding of these is limited, and government budgets cannot make up the difference, especially in resource-constrained post-pandemic circumstances. Therefore, significantly greater private investment must fill the gap.

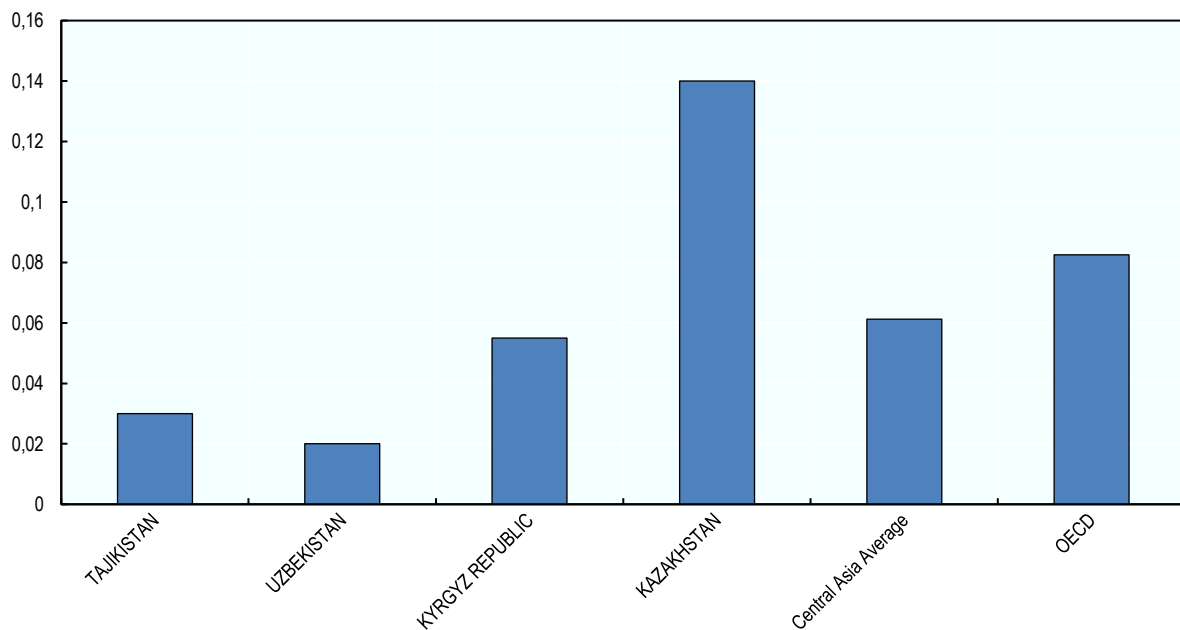
Central Asian countries overall have relatively liberal statutory regimes for telecommunications (Figure 23), yet significant investment remains elusive. This is partly due to implementation gaps, whereby the *de jure* freedom to invest is undermined by a challenging *de facto* operational environment for firms (OECD, 2021^[107]). For example, there have been a number of cases where large international telecommunications firms have exited Central Asian markets because of business climate issues. However, there are also sector-specific challenges, with accompanying solutions to attract greater investment.

Lack of competition and access to finance are serious impediments for ICT investment across the region. In some cases, inefficient SOEs and the crowding out of private investment are major problems, and

privatisation may be part of the solution. Uzbekistan is currently considering privatising 140 ICT SOEs, and notably, the government has already decided to privatise Uzbektelekom (President of Uzbekistan, 2020^[140]; Gazeta.uz, 2019^[141]). However, in some cases internet provision is a natural monopoly. Therefore, in the absence of complete privatisation, Central Asian governments may consider unbundling wholesale all-country coverage and “last mile” commercial functions.

Figure 23. 2020 FDI Regulatory Restrictiveness Index: Communications

Of the Central Asia countries surveyed in the OECD FDI Regulatory Restrictiveness Index, only Kazakhstan has a level of statutory restrictiveness to FDI in the communications sector higher than the OECD average.



Note: Values range between 0 for open and 1 for closed. Turkmenistan is not included in the OECD FDI RR.

Source: (OECD, 2019^[117])

While the latter is more conducive to competition and more suitable for private sector participation, it will only be effective if barriers to a level playing field are addressed – particularly in a number of key ancillary services. Another way to attract private investment and deal with natural monopolies of infrastructure is to create infrastructure-sharing programmes. These allow private investment, as part of public-private partnerships, into places where it would not be otherwise profitable to provide internet services by duplicating existing infrastructure (Burunciuc, 2021^[142]; OECD, 2021^[130]).

Raising levels of digital skills is crucial for firm productivity and innovation

For firms to make the most of the digitalisation agenda in Central Asia, governments must facilitate better access to training and education. Workers and firms need to have the skills to make the most of new digital solutions and recognise opportunities to innovate. To this end, increasing lifelong digital skills and integrating ICT through the curriculum must be a central component of education reforms at both the primary and secondary level. An early start to digital education can also make an important contribution to

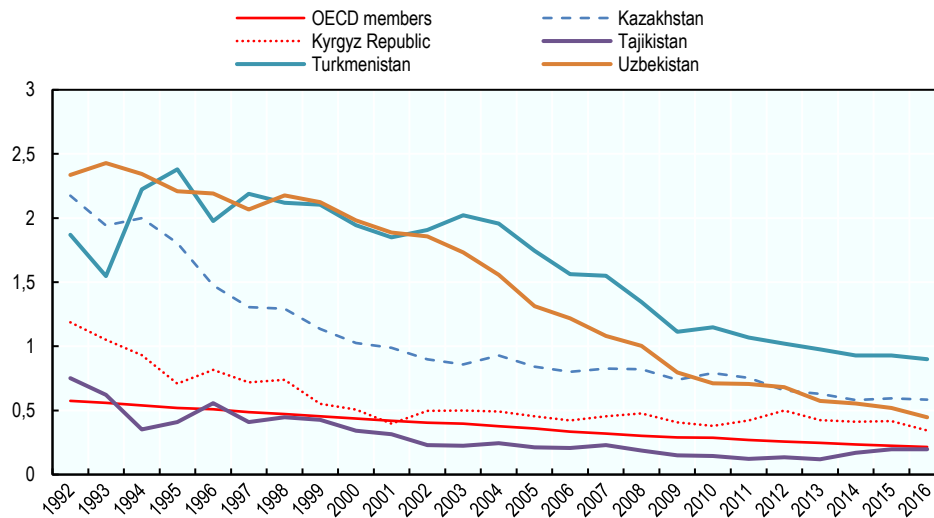
gender equality in the workforce (UNDP Kyrgyz Republic, 2021^[143]). Currently, Central Asian countries sit well below OECD averages for use of ICT in education. For instance, about two-thirds of OECD students use the internet for schoolwork every day, whereas only a third of Kazakh students do (OECD, 2018^[144]). Central Asian governments are aware of this issue. For instance, in 2020 Kyrgyzstan committed to both digital skills training and ICT integration in schools throughout the curriculum (Kabar, 2021^[145]; Sulaimanova, 2020^[146]).

A more immediate priority is upskilling workers and firms, which should be a key feature of digitalisation strategies. Many OECD countries have free adult education available online, or even in-person, localised programmes, such as Latvia’s community-based ICT trainings (OECD, 2020^[119]; OECD, 2021^[130]). Digital skills training can be offered at the firm level to SMEs in addition to individual workers. Governments can consider subsidising ICT education for SMEs, like the voucher system in Slovenia; directly offering BDS, such as Ukraine’s EU-supported Certified Digital Education Centres; or inspiring firms to obtain digitalisation BDS themselves by intensively supporting “digital champions”, as in Australia (OECD, 2020^[119]; Uvarova, 2020^[147]; OECD, 2021^[130]). These would enable the private sector, especially SMEs, to take advantage of the benefits of digitalisation, which include increasing productivity, accessing new markets, and – as clearly demonstrated this past year – having greater resilience to disruptions.

The green transition

The Soviet legacy of environmental neglect, high levels of energy intensity, and reliance on highly polluting agricultural, extractive and industrial sectors have affected Central Asian economies’ ability to transition to more sustainable economic models. Central Asian countries have already begun to experience the consequences of climate change for economic development. Diminishing water availability, higher frequency of natural disasters, and land degradation that threatens agriculture and food supply are challenges that are no longer hypothetical. These problems are exacerbated by environmental mismanagement.

While the region’s carbon footprint has shrunk significantly since the early 1990s, the environmental cost of growth remains high. The most recent data suggest each country in Central Asia, except Tajikistan, emits significantly more CO₂ for every PPP dollar of GDP than the OECD average (Figure 24). This reflects the ongoing dominance of carbon-intensive industries such as mining and hydrocarbon extraction, but it also reflects the region’s aging transport and energy infrastructure and the lack of policies to encourage decarbonisation and better energy efficiency.

Figure 24. Kilogrammes of CO₂ produced for every PPP dollar of GDP

Source: (World Bank, 2017₍₁₀₀₎)

As policy-makers in Central Asia chart the short- and longer-term recovery from the global pandemic, there is an opportunity to mainstream policies that could allow governments better to address climate- and environment-related issues. Governments can place greater emphasis on sustainability and diversification using public investment, international co-operation, and policy interventions that create incentives for greener and more resilient growth models.

Progress in stimulating a green transition

While Central Asia's economies remain carbon-intensive, the region's governments have recognised the need to address climate adaptation and decarbonise growth. Much of the region's carbon footprint comes from energy production, but a meaningful net-zero transition (NZZ) requires a full economic *transformation*. To that end, it is encouraging to see that each of the five Central Asian republics have made explicit commitments to a range of green economic reforms – from infrastructure and manufacturing to the greening of SMEs and the energy sector – in a number of key strategic documents.

Table 2. The green transition in Central Asia's national development strategies

Kazakhstan	Kyrgyz Republic	Tajikistan	Turkmenistan	Uzbekistan
The National Development Strategy of Kazakhstan, adopted in 2016, supported an unconditional Target of 15% reduction in greenhouse gas emission compared to 1990 by 31 December 2030. The country also adopted the Strategic Plan for Development	The National Development Strategy of the Kyrgyz Republic, adopted in 2018, promote the development of electric vehicle production. Additionally, the Green Economy Concept-"Kyrgyzstan Country of Green Economy", adopted in	The National Development Strategy of Tajikistan, adopted in 2016, aims to reduce the emissions of several sectors, such as water, industry, energy, and transport. The 2016 Programme for the Adoption of Renewable Sources of Energy and the Construction of	The National Development Strategy of Turkmenistan, adopted in 2016, sets a conditional target to achieve zero growth in GHG emissions and even reduce them by 2030. Similarly, the National Climate Change Strategy promotes economic diversification,	The 2018 National Development Strategy of Uzbekistan plans for the adaptation of several economic sectors to climate change. Additionally, the Strategy of the Republic of Uzbekistan for the Transition to a Green Economy ensures stable economic progress with

Kazakhstan	Kyrgyz Republic	Tajikistan	Turkmenistan	Uzbekistan
until 2025, which commits to increasing the promotion of investment in the green economy and supporting green finance. On 12 December 2020, Kazakhstan announced a target to reach carbon neutrality by 2060 as part of the nation's strengthened national climate plan.	2018, tackles the issue of attracting sustainable FDI and developing hydroelectricity and other renewables.	Small Hydroelectric Plants develops a strategy to increase electricity production, especially in remote highland areas.	including by increasing the share of renewable energy, with a focus on SME energy generation facilities.	minimal greenhouse gas emissions while introducing environmentally friendly criteria for investments.

Source: OECD, National governments of Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan

All five countries have signed and ratified the Paris Agreement. However, the depth of commitments to emissions reduction varies across the region. Kazakhstan and Uzbekistan are the only ones to have committed to achieving net zero emissions by the second half of the century. Ahead of the COP26 meeting in November 2021, there is an opportunity for the countries in Central Asia to heighten their ambitions and to turn intention into action by committing to the domestic reforms necessary to support the economic transformation to carbon neutrality.

Key challenges ahead

Governments should ensure that decarbonisation is guided by clear, well-designed roadmaps

Long-term low emissions development strategies (LT-LEDS) could act as an important green transition roadmap for the economies of Central Asia. To date, only Kazakhstan has developed an economy-wide LT-LEDS, while Uzbekistan has developed one for its energy sector. Similar strategies for the other Central Asian economies could help policy-makers ensure a co-ordinated, whole-of-government approach to the green transition and form a major part of their roadmap for the post-pandemic recovery. There are a number of key pillars that these strategies should include: (1) a clear vision and quantifiable targets in terms of GHG emission reductions, as well as qualitative targets for climate resilience and adaptation; (2) a strong institutional architecture, with a robust legal framework and stakeholder engagement, possibly achieved by conferring the strategy with a legal status, thereby making reduction targets binding; (3) an economy-wide perspective, while also carving out concrete sectoral plans for key areas of the economy; (4) adequate resources and monitoring systems; and (5) translation of the strategy into necessary bylaws, codes, and other policy instruments.

Governments in the region are also encouraged to increase regional co-operation on cross-cutting priorities. These priorities include decarbonisation of the economy and waste and water management. Regional connectivity will have to be improved to foster regional energy sharing and integration. These priorities will require not only regional dialogue, but also digital advancements and policy/technical advice from international partners.

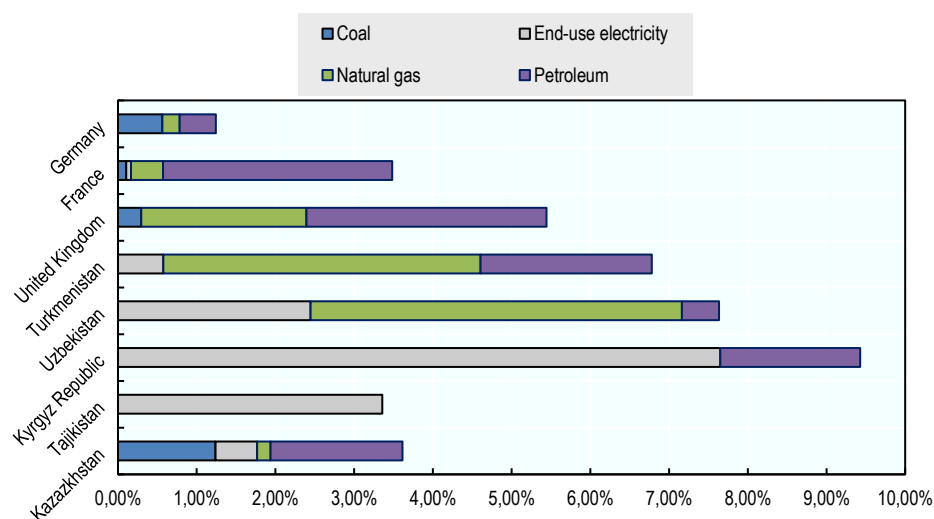
A range of fiscal policy levers could help accelerate and solidify the green transition in Central Asia

Fiscal policies have a large role to play in facilitating the green transition, and the recovery from the global pandemic is an opportunity to introduce new priorities in fiscal policy-making. Fiscal policies will play a large role in driving the green transition in Central Asia. Such policies will both change the direction of long-standing trends and facilitate investment in new, sustainable projects.

- **Carbon pricing.** If carbon emissions are under-priced in OECD and G20 countries, then they are significantly so in Central Asia. Kazakhstan, the only country in Central Asia to have an explicit carbon pricing policy, had an average allowance price in 2020 of just over USD 1.00/tonne, substantially below the Paris Agreement target price for 2020 of EUR 60.00/tonne and lagging the EUR 50.00 achieved by the EU in May 2021. Carbon pricing targets – or the introduction of such schemes where they do not already exist – will have to rise if the countries of Central Asia are to achieve their emission reduction targets.
- **Fossil fuel subsidies.** There is an encouraging downward trend in fossil fuel subsidies in Central Asia, but absolute levels remain worryingly high. Expressed as a percentage of GDP, energy subsidies in Central Asia are greater than in many G7 countries (Figure 25). The real value is likely much higher due to an OECD/IEA methodological approach that excludes certain subsidies to producers, such as price controls, which are commonly applied in a number of Central Asian countries. Managing the phase-out of such subsidies can be politically difficult, and any reform needs to be planned and communicated in advance, and to take into account the distributional effects. Ukraine's programme to divert subsidies into investments for energy efficiency could be a possible model for certain Central Asian governments.
- **Rationalising environmental payments and other tax incentives.** Governments must carefully assess the impact of existing environmental payments, taxes, and penalties on the decisions of firms to invest in R&D, innovation, and diversification. In Kazakhstan's mining sector, for example, the current taxation regime uses the country's mineral reserves as a tax base; in contrast to the more common profits-based approach used in many OECD countries. As a result, there is a risk that large investors will refrain from investing in extraction and processing, let alone engaging in R&D in low-carbon mining technologies.

Figure 25. Energy subsidies in Central Asia (% of GDP)

Central Asia continues to subsidise fossil fuel consumption.



Source: (OECD & IISD, 2021^[148])

Governments should support infrastructure investment that helps the region meet its emissions reduction targets

Reducing the environmental impact of infrastructure development is an essential component of any pathway consistent with the Paris Agreement and the Sustainable Development Goals. Infrastructure supports long-term economic development, but is also responsible for about 60% of all greenhouse gas emissions globally (OECD/World Bank/UN Environment, 2018^[149]). Central Asia faces a significant infrastructure investment gap, and the recovery from the COVID crisis presents an opportunity to address this gap as part of a sustainable recovery. Existing infrastructure objectives can be built into COVID-19 recovery plans, prioritising public investments and attracting FDI in sustainable, low-carbon, and climate-resilient infrastructure projects. The investment decisions made today could lock recipient countries into carbon-intensive development pathways, while greener decisions taken now could help tackle the triple challenge of closing the infrastructure gap, stimulating a resilient economic recovery and reaching long-term climate and development goals.

Ensuring that Central Asia's workers benefit from the green transition requires greater investment in skills that correspond to future industry needs

As with other areas of diversification, greater levels of investment in sectors that support the green transition will require intelligent labour market and skills policies. Governments should support the transferability of skills needed for emerging – or potential – green jobs and those used in traditional carbon-intensive sectors. Questions around the convergence of national qualification and occupational standards, skills certification, and on-the-job reskilling activities are all important here. Also essential are labour market institutions and policies that help workers who have suffered displacement avoid falling into long-term unemployment (the example of workers in coal and mining in many OECD countries is indicative here). Yet governments must also recognise that achieving a transition to a net zero economy will require accelerated innovation, and should take steps to encourage and support this with more general innovation policy and education in science and technology. Aligning education, skills, and science policy with future industry needs and creating incentives for R&D in low-carbon technologies are important steps, as is continuing to support the commercialisation of public research.

3. Leveraging BIOs to support business recovery and development

Introduction

While many restrictions on business activity have been consequences of public health interventions throughout the pandemic, they have complicated an already challenging business environment in Central Asia, affecting SMEs in particular. The pandemic has thus demonstrated the importance of ensuring that the private sector's voice is heard in policy-making, and it has highlighted the need to reinforce the role and competences of bodies providing effective public-private dialogue channels to influence policies.

In Central Asia, BIOs are among the primary actors that have historically assisted and represented the private sector, especially SMEs, playing a role as both service providers and conduits between policy-makers and the private sector.⁷ Research from other regions suggests that these typical roles of BIOs have increased in importance during the COVID-19 crisis (Russo, 2020_[150]). Hence, the current chapter analyses the response of BIOs in Central Asia to the pandemic as a case study contributing to the discussion of how to manage the impact of policy interventions on the private sector during moments of crisis, and how to improve public-private dialogue more generally.

This chapter relies entirely on information from an OECD survey of business associations across the region (Box 2), as well as project results from the EU Central Asia Invest (CAI) programme (Box 4). It will first look at how BIOs in Central Asia administered support before and during the pandemic, before discussing how BIOs can be further developed as a means to support private sector development.

⁷ BIOs refer to a range of business intermediary organisations, including: chambers of commerce, regulatory bodies promoting trade, industrial and professional associations, employers' federations or agencies, or a sector-based agency concerned with working with SMEs.

Box 2. Survey of business associations in Central Asia

The OECD received 18 responses to its anonymous survey of BIOs in Central Asia. Respondents include seven BIOs in Kazakhstan, five in Tajikistan, three in Uzbekistan, and two in Kyrgyzstan; one has branches in multiple countries. Twelve are sector-specific associations in fields as diverse as tourism, sewage, and microfinance. The others are have broader remits, such as Chambers of Commerce and Unions of Entrepreneurs.

The organisations represent a wide array of large and small BIOs, ranging from five members to thousands, with a median of 48. Most serve non-exporter SMEs, but several have mainly large corporate members. For example, one represents 3000 small businesses with an average 2-5 employees and USD 4800 annual turnover, only 10% of which are exporters. On the other end of the spectrum, a different association represents 20 large members, each with over 1000 employees, half of which are exporters. A few others have members in both groups, sometimes with different categories of membership based on firm size.

The role of BIOs in private sector development

BIOs have played an important role for firms since independence

Soviet *profsoyuzy* (trade unions) were the largest non-Communist Party organisations in the USSR. They represented nearly every profession and acted more like labour unions than business associations, although they performed both functions. In reality, their principal functions were to act as top-down “transmission belts” communicating directives from the party and government, and their ability to challenge managerial decisions or abuses was limited (Butt, 1978_[151]).⁸ These were complemented by Chambers of Commerce and Industry (CCI) of the USSR, which were primarily focused on export promotion – though these were relatively weak, because export activity was not generally encouraged in the Soviet system (Kossev and Tompson, 2020_[152]). They grew more active in the final years of the Soviet period and provided an institutional basis for further development as the market transition unfolded.

The current Kyrgyz and Tajik CCI still trace their origins to the Soviet Republican branches of CCIs but they have broadened their focus to more general private sector development (Chamber of Commerce and Industry of the Kyrgyz Republic, 2021_[153]; Chamber of Commerce and Industry of the Republic of Tajikistan, 2020_[154]). Both professional unions and CCIs in the Soviet era were centralised and state-run and participation was mandatory. The main chambers of commerce of Central Asia, despite claiming to be non-governmental organisations, continue to be government-funded and established by acts of national law, with primarily mandatory membership, similar to Soviet institutions. It thus remains difficult at times to assess the independence of the CCIs. Critics express concern that some represent specific private interests or liaise too closely with the government rather than advocate for the interests of all members (Usmanov and Naidenova, 2019_[155]).

Modern non-governmental BIOs, including industry-specific ones, started emerging following the demise of the Soviet Union and the beginning of market reforms. Stimulated by the poor business environments in the region, firms were incentivised to engage in collective action (Duvanova, 2013_[156]). BIOs thus

⁸ Trade unions did nevertheless play an important role in workers’ daily lives at times, since they handled many social functions, such as booking stays in sanatoria, organising sports clubs, etc.

naturally developed as the voice of the private sector and as a service provider to fill the void during the transition. They helped lower transaction costs, facilitate market access, and provide trade information across all sectors. In many cases, BIOs were drivers of post-communist reform efforts (CIPE, 2008^[157]).

Box 3. Overview of the BIO landscape in Central Asia

- International business associations, such as the European Business Association (EBA), American Chambers of Commerce (AmCham), the German Chambers of Commerce Abroad (AHK), and others assist firms throughout the region, mainly focusing on foreign investors and export-oriented local firms.
- In Kazakhstan, business associations participated in high-profile advisory bodies supported by the executive branch during the transition period. However, this trend ended in the late 1990s as government support dwindled. The main business association, which accredits independent BIOs (of which there are 186) and in which membership is mandatory for all private companies, is the National Chamber of Entrepreneurs of the Republic of Kazakhstan *Atameken*, established in 2013 with government participation (National Chamber of Entrepreneurs "Atameken", 2021^[158]). It now hosts the national business ombudsman as well (Usmanov and Naidenova, 2019^[155]).
- In Kyrgyzstan, 16-20% of all businesses are estimated to belong to BIOs, trade unions and organisations of employers (Holzhacker and Skalkova, 2019^[159]).
- In Tajikistan, the government committed to supporting the development of entrepreneurial associations within two large policy frameworks, the *2012-2020 Programme on State Support to* and the *2016-2020 Mid-Term Economic Development Programme (MEDT)*. There are an estimated 140 BIOs in the country (Usmanov and Naidenova, 2019^[155]).
- Turkmenistan has two major government-run BIOs: the CCI and the Union of Industrialists and Entrepreneurs (23,900 members), the latter of which is currently creating a variety of subsidiary sectoral associations (Union of Industrialists and Entrepreneurs of Turkmenistan, 2021^[160]). However, several independent BIOs also exist, such as the Turkmen Logistics Association and U.S. government-supported Union of Entrepreneurs (Turkmen Logistics Association, 2021^[161]; Union of Entrepreneurs of Turkmenistan, 2021^[162]).
- Uzbekistan's CCI is officially an NGO, but it is established by law and membership became mandatory for large businesses (remaining voluntary for small businesses and individual entrepreneurs) since 2018 (Republic of Uzbekistan, 2018^[163]). Since Uzbekistan's business landscape is dominated by small firms (54% of GDP, compared to Kazakhstan's 31%) (Finprom, 2021^[164]), merely 3.1% of all firms are currently members of the Chamber (Ayubova, 2020^[165]). There are a number of sectoral associations as well.

BIOs as service providers for their members

Many business associations gain credibility and members by providing services and benefits, such as legal and technical consulting, assistance in finding new business partners, help with business plans, marketing advice, and professional training. Before the pandemic, the vast majority of surveyed BIOs were engaged in business development and education services (88% and 81% respectively). For instance, the Chamber of Commerce and Industry of Kyrgyzstan offers training courses based on members' recommendations, such as on filing taxes (OECD, 2020^[166]). Examples of education from surveyed BIOs include certifying

graduates of educational institutions, conducting expert analysis of college educational programs and syllabi, and publishing technical journals, magazines, and conference proceedings. Slightly fewer (but still a sizeable majority) create technical standards (69%). Membership in one or more business associations may also have a positive effect on the uptake of business development services (BDS) from private companies, as it allows firms to become more aware of opportunities and to obtain referrals to BDS providers. An OECD survey with 250 Kyrgyz businesses found that 15% had previously sought BDS through business associations; of those that did, 83% were satisfied with the results (OECD, 2020^[166]).

BIOs as a voice of the private sector

According to the OECD survey, respondent BIOS perceive PPD as an important private sector support mechanism, with 81% engaged in such platforms before the pandemic. To collect information on how policies are affecting their members, the majority of surveyed BIOS conduct annual surveys (65%), set up electronic channels for businesses to express their grievances, and meet regularly with representatives of specific sectors or businesses more generally (OECD, 2020^[166]).

Having understood their members' feedback, BIOS engage with the government on their behalf. For instance, the Kyrgyz Chamber of Commerce meets annually with the Ministry of Economic Development to highlight business needs and challenges. PPD can be an effective mechanism for improving policy in Central Asia. For example, in 2015, GIZ supported capacity building for BIOS in Tajikistan so that they could engage in newly developed PPD platforms. Their participation led to the development and introduction of a number of reforms, for instance, the government adopted an action plan developed by the tourism working group, which removed certain administrative barriers (Kosymova and Abdujaborov, 2015^[167]).

At the same time, the OECD survey revealed that BIOS are worried about their capacity to engage and influence policy-making. Some may not have the money or time to engage with policy-makers, and others noted the monopoly that some larger BIOS have on interactions with the government, rendering it difficult for small BIOS to make their voices heard. Nevertheless, many small and sector-specific associations – for instance, one Kyrgyz association with just two employees and 48 members – engage quarterly in multiple PPD platforms, such as consultative councils and government working groups (OECD survey, 2021).

Box 4. Sri Lankan BIOS successfully lobbied to transform local business environments

Local BIOS and governments in Sri Lanka made a variety of efforts to interact in 2005-2006. An ILO programme collaborated with local branches of the Chamber of Commerce to host SME Policy Days. These events were opportunities for micro and small business owners to present their experience to policy-makers, for which the programme had given them support and training at prior working groups. This was complemented by local-level surveys.

As part of a Local Competitive Advantage (LOCA approach), forums were held in each district with MSE and government representatives. Some of these resulted in immediate policy changes, and others prompted small businesses to form new BIOS. However, the programme concluded that more outreach efforts were needed to convince small businesses of the benefits of participating in PPD.

Source: (Dyce, 2006^[168])

BIOs also aim to protect the rights of businesses, which is important in a region such as Central Asia, where implementation often differs from the *de jure* legal and regulatory frameworks for businesses and investors (OECD, 2021^[107]). Aiming to resolve industry conflicts internally, chambers of commerce in Uzbekistan and Kazakhstan have created business ombudsmen, and Kyrgyzstan's Chamber is a close partner of the ombudsman office (Business Ombudsman Institute, 2021^[169]). However, the Chambers are not the only BIOs to protect the rights of businesses; in normal times, 69% of surveyed BIO reported doing so.

Box 5. Labour unions during the pandemic

The OECD's Trade Union Advisory Committee (TUAC) has been closely following the activities of unions in various countries during the pandemic. Unions are an important counterpart to BIOs; the former represents the labour force, and the latter businesses. While interests occasionally conflict, the goal of both types of organisation is a healthy economy. Many of the responses of unions match those of BIOs, albeit for a different audience:

- advocacy, often in the form of formulating proposals and demands for the government to protect workers, including the unemployed (all countries);
- writing a guide for combatting the spread of the virus in workplaces with government officials (Belgium);
- conducting surveys on the impacts of the pandemic (Netherlands);
- collaborating with BIOs on joint agreements for how workplaces should operate during the pandemic (Iceland, Israel), or in a tripartite format with the government as well (Spain);
- spreading information about good and bad employment practices during the pandemic, to name-and-shame those mistreating their workers and provide a model for good decisions (Australia);
- creating a hotline to advise the public on work-related topics like short-term employment (Austria); and
- fundraising and contributing own funds to relief efforts (Italy, United Kingdom).

When such opportunities are available, collaborating with labour unions can be a productive way to ensure a healthy recovery from the pandemic and possibly increase the impact of activities, such as broader surveys or joint policy statements.

Source: (TUAC, 2020^[170])

The pandemic made it difficult for BIOs in Central Asia to continue supporting and representing their members

Business associations, like their members, face challenges in their development, both external (government regulations, the pandemic) and internal (low capacity, lack of specialised staff and funding, unfavourable membership structures).

Even before the crisis, 70% of surveyed BIOs reported budget constraints as a challenge to expansion. Nearly all surveyed BIOs rely on membership fees for funding, and more specifically, membership fees are

the *primary* source of funds for half of the BIOs. The rest mainly rely on grants from the development community due to the capacity of BIOs to be vectors for private sector development. In the past decade, BIOs in Central Asia have received significant support – both financially and administratively – from the development community, including CIPE and the EU Central Asia Invest Programme (Box 6) (CIPE, 2021^[171]; EU Delegation to Kazakhstan, 2021^[172]). Prior to the crisis, this perhaps helps explain the longevity (average age of surveyed BIOs is 15 years) and institutionalisation of BIOs in Central Asia despite ongoing financial problems.

Box 6. The EU Central Asia Invest programme's contribution to BIO development

The Central Asia Invest Programme, launched in 2007, aims to support MSMEs by reinforcing the role and the competences of BIOs, increasing their capacity to support MSMEs, and influencing policies in their favour.

Thanks to the programme, 41 projects totalling 26.2 million euros have been implemented jointly by BIOs from EU Member States and Central Asia. Over 60 BIOs enhanced their competences in supporting MSMEs, thus contributing to improving the business climate and fostering regional integration. In addition:

- over 800 BIOs benefited from the CAI actions and improved their services to SMEs;
- over 38,000 SMEs received trainings, capacity building assistance, etc.;
- around 20 information, training, support, and network offices were set up;
- more than 15 new business associations were founded;
- 15 SMEs or staff members of SMEs and BIOs received international certifications;
- over 100 beneficiaries received national certifications (touristic accommodation, etc.);
- around 20 study tours were organised; and
- beneficiaries participated in international events including the World EXPO in Milan (2015) and the ITB in Berlin, the largest global travel fair.

In 2020, the programme financed seven new projects to enable private actors to have better access to finance, enhance entrepreneurial skills of young people and job seekers, unlock business potential in underexploited sectors such as tourism, introduce green solutions along the whole value-chains in more traditional sectors, and promote the digitalisation of the economy.

Findings from the projects, collected throughout multiple newsletters in 2020, have fed into this report.

Source: (EU, 2020^[173])

Pre-existing financial problems became worse during the pandemic, with 59% of surveyed BIOs reporting funding difficulties. One BIO noted that the development community funds remained stable, which helps those that depend on grant funding. However, the reliance of the majority of respondent BIOs on membership dues means that when the private sector suffers financially, so do BIOs. Many in-person paid events had to be cancelled, which also took a toll on BIOs' revenues. The tourism sector was particularly badly affected, prompting some members of the EU-funded CAI Silk Road Community Based Tourism (CBT) initiative to shift activities to more stable sectors. As a result, no surveyed BIO was able to provide financial support to members during the pandemic. Some had to conduct salary cuts, and service provision was reduced below pre-pandemic levels.

Constrained budgets have a direct impact on the ability of BIOs to support their members. The lack of qualified staff and trainers – a problem for 41% of surveyed BIOs – is partly due to the inability of NGOs to pay adequate salaries to attract top talent, as several respondents noted. In turn, this reduction in quality and quantity of services may make it difficult for BIOs to raise interest among potential members, which 47% of surveyed BIOs said was a challenge (the second biggest challenge to expansion after budget).

BIOs could not deliver their usual support services

Seventy-one percent of surveyed BIOs reported that they struggled to act as a support mechanism for the private sector during the pandemic. On average, they rated their degree of support as moderate, 3.3 out of a possible 5. Only 50% reported serving as information channels for businesses, compared to 100% before the pandemic. While 63% of surveyed BIOs said they had hosted training sessions during the pandemic, this represented a decline from pre-pandemic levels. Less than 40% of surveyed BIOs reported being able to provide BDS, digitalisation support, surveys, or policy advocacy after the start of the pandemic. Some of the reduction in activities was a direct result of the inability to meet in person or to travel. For example, a Kazakh association had to cancel a study visit to Latvia, and the topics of some of their planned longer-term business development projects became less relevant as members struggled with immediate challenges.

In lieu of in-person services, digital delivery became the only option. Along with constrained budgets, problems with digitalisation constitute a likely explanation for the difficulties BIOs faced when offering services. More than one-third (35%) of the surveyed BIOs noted digital infrastructure as a barrier to expansion even before the pandemic. Surveyed BIOs said that digital infrastructure, the cost of digital solutions, and skills were major problems (59%, 47%, and 47% respectively) in their members' attempts to adapt to the pandemic (see Chapter 2). BIOs themselves also likely suffered from similar issues, as only 31% were able to help their members with digitalisation, thereby compounding the issue, since non-digitalised members would not be able to make use of digital services, even if they were offered by BIOs.

Box 7. Moldova's Alliance of Small Enterprises stepped up its role as an intermediary between the government and businesses during the COVID-19 pandemic

Only informed businesses can make sound decisions in times of crisis, and even when businesses know what they should do, they may not know how to do it. For these reasons, the Alliance of Small Enterprises in Moldova worked in partnership with the Swiss CSO Helvetas to ensure small businesses throughout the country – not only its own members – would have the information they needed to survive the crisis.

In the first two weeks of lockdown, the Alliance of Small Enterprises provided individualised advice to over 1000 businesses. Realising the high demand for these services, they created a task force comprised of expert consultants in various areas (legal, financial, etc.) paired with knowledgeable business partners. For example, a travel agent received legal advice on how to manage re-bookings, which was even more important to preserving her business than direct financial support.

The Alliance is also engaged in PPD. In the first two days of the pandemic, it developed a position paper on policies that would help small businesses. As of May 2020, they were developing a coalition with other BIOs to deliver unified recommendations to the government.

Source: (Tibuleak et al., 2020^[174])

Limited trust between stakeholders and unequal representation of firm types in BIOs affect successful PPD

Another issue the survey brought out is the low levels of trust between stakeholders, the lowest being between BIOs and the government. In part, low levels of trust may reflect a general restrictiveness and bureaucratic barriers on non-governmental organisations across the region. For instance, the 2015 amendments to the Tajik Law “On Public Associations” tightened control through heightened inspections and added obligations for associations to disclose their funding. Although these measures primarily targeted civil society organisations, they also affected business and professional associations with more administrative barriers and inspections amidst already constrained budgets. Additionally, relationships between BIOs and the government in Tajikistan are not institutionalised, but rather depend on the strong personalities of certain BIO leaders with whose connections to the government aid informal lobbying (Usmanov and Naidenova, 2019^[155]). Such champions can be useful, but over-reliance on them risks the sustainability of PPD. Even when dialogue is regular and institutionalised, as in Kyrgyzstan, BIOs question the degree to which it affects policy.

With the pandemic, government-BIO relations have become further strained, and PPD has suffered as a result. In the OECD survey, BIOs rated trust between themselves and the government at 3.8 out of a possible 5 on average. They reported higher levels of trust between BIOs and international donors, the private sector, and other BIOs. While BIOs acknowledged that the government supported the private sector during the pandemic, mostly through tax relief, they rated this support 3.3 out of 5 on average, the same rating they gave to themselves. Government support for BIOs was negligible, rated 2.2 out of 5, though it may be understandable that governments gave greater priority to direct support for firms than for intermediaries. Changing government regulations was the top ongoing concern expressed by surveyed BIOs (68%). Many reported significant worries for the future, including the unpredictability of both economic

conditions and government policies. During the pandemic, the proportion of BIOs engaged in policy advocacy dropped by over half, from 81 to 38%, at a time when it was especially important that the voice of the private sector be heard by policy-makers.

There is also scope to increase trust between BIOs and their members, as there are concerns that representation may not always be equitable. The Uzbek government recently started requiring large corporations to join the Chamber of Commerce, but SMEs are exempt. This may save SMEs from additional fees and administrative burdens, but it also means that large companies will have a much greater voice in the Chamber's PPD (Republic of Uzbekistan, 2018[163]). In addition, BIOs, especially independent and sectoral ones, may be underrepresented in the regions. For instance, the Kazakh National Chamber of Entrepreneurs Atameken, with obligatory membership for all private companies, receives government support in the form of its legal mandate and an allocation of USD 6.7m in 2021 (34% of Atameken's overall budget) to expand its services across the country (National Chamber of Entrepreneurs "Atameken", 2020[175]; 2021[158]). In contrast, industry associations, which are non-mandatory and therefore have fewer members, receive no government support. Therefore, they may face budgetary barriers to expansion, leading to a lack of PPD opportunities for specific industries. These issues can compound the problem of BIO-government trust. This is demonstrated by the situation in Kyrgyzstan: the government accuses BIOs participating in the tripartite PPD platform of having insufficient membership, particularly among youth and the self-employed, to speak on behalf of the private sector (Usmanov and Naidenova, 2019[155]).

Despite these challenges, BIOs were resilient and adapted their support to help businesses weather the crisis

The impact of the pandemic on both businesses and their BIOs has been severe. At the same time, the OECD survey has revealed their willingness to adapt their working and communication methods. The situation is reported to be stable; many BIOs have returned to working on site, with stricter sanitary measures in place.

Some BIOs did adapt well to the pandemic thanks to digital technologies. Many started teleworking, and some offered digital training and conferences. Considering limited access to the internet in some regions of Central Asia, BIOs even – if the epidemiological situation allowed – clustered businesses in different groups with access to laptops, so they could continue benefitting from online trainings. BIOs also started reorganising their budgets, reducing transportation and communication costs to dedicate more funds to digital tools. Many housing management companies migrated to online platforms for information, communication, and customer feedback on their services. One association enabled consumers to contact their management electronically, and others used electronic payment systems to facilitate payment for their services (OECD surveys, 2021).

Policy advocacy was also adapted for the reduced number of BIOs that were able to engage during COVID-19. To be able to speak on behalf of businesses and assess the current challenges they face, 38% of surveyed BIOs conducted surveys. For instance, the American Chamber of Commerce in Uzbekistan surveyed members during the pandemic and found that small businesses primarily needed services, while large ones sought PPD. As a result, the organisation named developing digital services one of its top three priorities for the next few years and joined a government working group on a new labour code. Thirty percent of their recommendations were incorporated, and partially as a result of good publicity, the Chamber observed an *increase* in membership during the pandemic (Bystrushkina and Power, 2021^[176]).

Coalitions started forming between associations to approach the government collectively to seek support. Several used virtual PPD platforms and provided information to members through government websites

like egov.kz and Telegram channels. Others participated in more traditional PPD (albeit often through videoconference), including working groups with the Government to develop measures to support the economy and disseminating information on government SME support. For instance, one association addressed a letter to the Kazakh president with a request to expand the list of employees receiving state aid. Because of such requests, the Kazakh government has taken a number of measures, including: granting a grace period on loans until the end of the year, the cancellation of corporate income tax for the current year, and non-accrued payments for the rent of state-owned premises. In Uzbekistan, the Ministry of Investments and Foreign Trade allowed entrepreneurs to channel their applications for government support through the CCI.

Key challenges ahead

BIOs can provide valuable information and BDS to businesses, but they may need government and donor support

Governments can help BIOS provide crucial information in times of crisis. With rapidly changing conditions, information on the legal environment has been one of the most urgent needs of businesses. BIOS across the world immediately stepped up to fill this role. Canadian BIOS included online information hubs with fact sheets, graphics, guidance documents on specific topics like mental health, and links to government and CSO resources (Greco, 2020_[177]). Despite far fewer resources, nearly a quarter of Sub-Saharan African BIOS distributed information to their members about new government policies and restrictions (Russo, 2020_[150]). Information channels go both ways, of course. Since governments also need to know about the impact of the crisis on businesses to make effective policy, they can commission surveys from BIOS, which would be a source of additional income for the latter. Governments can also make use of synergies with PPD by collecting input from BIOS and their members, while also providing information to them about new policies, which BIOS can then distribute.

Improving digital services and online presence can allow BIOS to continue providing value to members, but they may need help with digitalisation. One of the biggest challenges facing BIOS and their members is being able to move operations online. Businesses, particularly MSMEs, may need substantial support to do so, and in some cases BIOS can provide this support (Tibuleak et al., 2020_[174]). For instance, some African BIOS offered social media and e-commerce trainings for members (Russo, 2020_[150]). However, to help members transition to a digital world, BIOS themselves need to make that transition first. BIOS would greatly benefit from donor-funded capacity-building and training-of-trainer programmes. Many Central Asian BIOS do not have updated websites or social media accounts (Usmanov and Naidenova, 2019_[155]). Now that even more businesses are seeking information online, it is crucial for BIOS to upgrade their overall communications and digital delivery strategies (CIPE, 2016_[178]).

Governments at all levels should work with BIOS to ensure that SME voices are heard

BIOs and governments must ensure that PPD is transparent and inclusive, and that they are representing the interests of SMEs (OECD, 2007_[179]). In difficult economic conditions, large and well-connected firms are often best positioned to survive, since they can make “backroom deals”, even if this risks having a negative impact on the overall economy (World Bank & CIPE, 2015_[180]; CIPE, 2008_[157]). Even BIOS that have majority-MSME membership can sometimes be dominated by large corporations, which have more resources to devote to PPD (Dyce, 2006_[168]). Large BIOS can counteract this effect by proactively gathering information and soliciting diverse viewpoints from micro enterprises (which tend to dominate the firm landscape across Central Asia), women-owned enterprises, and businesses outside

capital cities. Strategies for this include openness to any member that meets clearly published criteria, lower dues for smaller companies, and an internal democratic, horizontal governance structure that provides all members with an equal voice (CIPE, 2016^[178]; OECD, 2007^[179]; OECD, 2018^[181]). Donor funding and capacity building to support small BIOs may be necessary, since policy advocacy in BIOs suffers from a collective action problem: it benefits the business community as a whole, but not any one member in particular (OECD, 2007^[179]).

Local governments should be part of the PPD process. Since COVID-19 has had an unequal impact on urban and rural areas and local BIOs are more likely to represent regional SMEs, local government should better engage with regional BIOs. In such circumstances, partnerships between local governments and local BIOs can be extremely fruitful (Usmanov and Naidenova, 2019^[155]). If there is a revealed effect of local policy advocacy, small businesses have incentives to join. This leads to increased formalisation, which would be particularly beneficial in Central Asia (Dyce, 2006^[168]). These local efforts can have national benefits. Subnational chapters of business associations can channel information about local conditions to the national association, which represent their interests to the national government (World Bank, 2014^[182]).

BIOs can support sustainable recovery by leveraging their collective influence during the crisis

Forming coalitions and partnerships is a core function of BIOs and can be a powerful tool to increase impact (CIPE, 2016^[178]). In parts of Central Asia, distrust between stakeholders is relatively high, but the situation is improving. In Kyrgyzstan, for example, several organisations united into one National Alliance of Business Associations to work on their common interests in reforming the tax code, and during the pandemic other coalitions began to form (Usmanov and Naidenova, 2019^[155]). Such coalitions can significantly increase the policy impact of BIOs.

Even during a crisis, long-term issues like corruption and climate change should remain on the agenda. Business associations can play a leading role in promoting long-term and sustainable goals through the recovery period since they help solve a collective action problem: it would be beneficial for all companies to embrace social responsibility, but only if their competitors did so as well (Martini, 2013^[183]; United Nations Global Compact & International Chamber of Commerce, 2015^[184]). BIOs can support environmental and anti-corruption efforts of all members with training, certification, and policy advocacy. This not only benefits members, but also generates significant positive externalities for society. For example, in Thailand BIOs worked with CIPE on an anti-corruption programme. The first step was commitment from all members to refuse to pay bribes, followed by practical training for members on how to ensure this, and finally certification for companies that met ethical standards (Martini, 2013^[183]). The international Aluminium Association set specific objectives to improve recycling of their product and reduce carbon emissions, resulting in an 85% emissions decrease within 20 years. This was facilitated by extensive research through member consultations and the subsequent development of guidelines and assessment indicators. Throughout the process, the Association made a particular effort to engage small businesses in its dedicated Sustainability Committee; leadership of the committee rotated and frequently was held by SMEs (United Nations Global Compact & International Chamber of Commerce, 2015^[184]).

4. Conclusion

Protecting public health and ensuring flexible reopening are key to short-term recovery

Swift and effective vaccination campaigns will be crucial to mitigating the human and economic impact of the pandemic on Central Asia and creating a solid platform upon which a recovery can be built. While governments across the region have expressed an ambition to vaccinate a majority of their populations by the end of 2021, significant procurement and administration pressures remain barriers to a successful rollout. While these pressures in large part stem from issues around healthcare capacity and logistical constraints that predate the crisis, governments must find short-term fixes, both nationally and in co-operation with regional peers and international partners. First responses to the crisis have shown an increasing trend towards regional co-operation, which could lead the development of a regional, inclusive and mutually beneficial recovery agenda.

The measures implemented by governments in Central Asia to support their private sectors broadly matched those seen in OECD countries, differing in most cases only in terms of scope and resourcing. Attention will now turn to how to roll back support without endangering recovery. In Central Asia, where fiscal space is limited and macroeconomic challenges are more acute than in OECD countries, this is a balance that must be managed carefully. The importance of export revenues and migrant remittances, high levels of external debt, persistent inflation, and narrow tax bases are at the root of low economic resilience in the region, and raise sustainability questions around continued public intervention if left unaddressed. Structural issues rendered Central Asia particularly vulnerable to the economic impact of the pandemic.

When the global pandemic first hit Central Asia, it did so in a context where the traditional drivers of regional economic growth had been running out of steam: trend GDP growth had been decelerating since the 2008 Global Financial Crisis, productivity growth was stagnating, inequality was rising, and convergence with OECD and EU countries was slowing. Despite reforms across the region in the years preceding the pandemic, underdeveloped private sectors, serious defects in the business climate, overreliance on exports of primary commodities and migrant labour, weak competition and high levels of informality had contributed to a loss of momentum. Central Asian states were in need of new, more resilient and more sustainable growth models.

The challenge facing the region now is three-fold.

- First, they must ensure that firms and workers emerge from the ongoing crisis in as strong a position as possible. This will require careful management of the withdrawal of support, minimising the exit of viable firms. Support must be better targeted and market disciplines should once again allowed to operate normally.
- Second, governments must redouble efforts to address the many structural weaknesses that were apparent before the crisis and that have compounded its impact. This means improving the domestic business climate to create more favourable conditions for entrepreneurship, investment and innovation.
- Third, as discussed in Chapter 2, policy-makers must ensure that policies are developed and implemented to maximise the future competitiveness of Central Asia in the global economy as the

world navigates the low-carbon transition and the digital transformation. Successful management of these processes will be critical to productivity growth, job creation, and investment.

Laying the foundations for a more sustainable economic future

Before the COVID-19 pandemic, reforms in Central Asia were driven mainly by concerns about the declining effectiveness of the region's traditional drivers of growth – primarily the export of surplus labour and extractive goods and the expansion of non-tradable activities associated with these. In a post-pandemic context, recovery planning requires coping with a remaining high degree of uncertainty in the global economy, in order to adapt to a more competitive climate for foreign direct investment, and to keep up with an international shift towards decarbonisation. These challenges add to the structural weaknesses that need to be addressed in Central Asia, while a continuously expanding labour force will further increase the need for quality jobs.

The pandemic has increased the opportunity cost of insufficient reform across Central Asia, while requiring governments to simultaneously navigate an unpredictable and still challenging public health crisis and plan for stronger and more resilient economies. The four areas discussed in Chapter 2 – better public revenue management, improving the business climate, accelerating the digital transition, and embedding the green transition into all areas of economic policy – could create the foundations needed to set the region on a more sustainable and inclusive economic trajectory.

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BEYOND COVID-19

PROSPECTS FOR ECONOMIC RECOVERY IN CENTRAL ASIA

The arrival of the COVID-19 pandemic in Central Asia in early 2020 had a profound social and economic impact on a region still recovering from the effects of the 2008-09 Global Financial Crisis and the 2014-15 commodity price shock. Structural weaknesses linked to both public- and private-sector capacities rendered the Central Asian countries particularly vulnerable to both the economic and public-health impacts of the crisis. In the short-term social and economic recovery will depend on the effectiveness of vaccination campaigns and support measures, but longer-term prospects will require steps to address these weaknesses. An ambitious reform agenda aimed at strengthening the foundations for a private sector-driven recovery is essential. Improvements to the business climate need to be complemented with measures to address longer-term challenges such as digitalisation and climate change. Prospects for recovery in Central Asia will therefore depend on the ability of governments to turn the crisis into an opportunity for deeper reform implementation.

This report, part of an ongoing project co-financed by the European Union, explores the macro-economic impacts of the pandemic on the economies of Central Asia and assesses the overall policy responses of governments, including the factors affecting their policy options. The report then identifies four priority policy areas for a strong economic recovery: public revenue management, the business climate, digitalisation, and the green transition. It also explores one specific way to ensure that policies reflect needs of business through an analysis of the contribution of business intermediary organisations (BIOs) to private-sector recovery. It offers specific policy recommendations on these priorities for the region.